Shifting Balances of Power
and New Forms of Corporate Control
Three Essays on Corporate Responsibility and Corporate Governance
in a Globalized Economy

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The Faculty of Economics, Business Administration and Information Technology of the University of Zurich hereby authorizes the printing of this Doctoral thesis, without thereby giving any opinion on the views contained therein.

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1 Introduction

1.1 Overview

The power of business firms has grown considerably in the current globalized economy (Barley, 2007; Beck, 2000). Simultaneously, the power of nation states to regulate business has diminished (Habermas, 2001; Strange, 2000). Whereas the influence of national governments is limited to their respective territory, many business firms are to a considerable extent globally mobile. Consequently, the prevention by law of negative externalities of business activities such as environmental pollution or the violation of human rights in global value chains is difficult and in many instances even impossible. For example, while numerous international major fashion brands are involved in the recent disasters in garment factories in Bangladesh (Gayle, 2013), legal prosecution is limited to local actors (Huffington Post, 2013). Furthermore, business firms increasingly assume tasks that are traditionally regarded as the responsibilities of democratically elected national governments, such as the provision of public goods (e.g. in the cases of business firms providing infrastructure or public services) and regulation (in the case of business regulation through private standards). In these cases business firms assume a political role. However, they often lack democratic legitimation for such activities. Taken together, these developments indicate that the balance of power between business firms and governments has shifted in favour of the former (Goldblatt et al., 1997). At a first glance, this claim is contradicted by tightened regulation in areas such as financial markets (European Parliament, 2010a; Moloney, 2010) and disclosure practices of business firms (Kinderman, 2013) in the aftermath of the financial crisis of 2008 as well as by recent plans of the OECD to tackle the problem of tax avoidance (Inman, 2013; see also Palan, Murphy, & Chavagneux, 2010). These developments suggest that governments and international organizations are capable and willing to regulate the conduct of business firms. However, at a second glance, political decisions are still strongly influenced by lobbying and agenda setting activities of business firms (Barley, 2007; Crouch, 2011; Nownes, 2006) and the regulatory adjustments of the financial system are rather fragmentary with the institutional frameworks left unchanged (Froud et al., 2012; Hellwig, 2010). These issues suggest that a strengthened involvement of civil society in political decision processes (Crouch, 2011) and the redesign of oversight mechanisms according to democratic principles (Engelen et al., 2012) are preconditions for a thorough structural reform of the financial sector as well as of the economy as a whole.

An emerging body of research (Matten & Crane, 2005; Palazzo & Scherer, 2006; Scherer, Palazzo, & Baumann, 2006; Scherer & Palazzo, 2007, 2011) is turning attention to the changing role of business firms in a globalized world, analysing different facets of this development. Adding to this literature, in this dissertation I first analyse the implications of an increasing importance of business contributions to public policy. Currently, business firms assume more and more tasks that are traditionally regarded as the domain of governments. Therefore, a predominance of economic reasoning as a guiding principle for societal coordination is increasingly likely. Due to a potential disregard of the negative effects of business activities on individuals and the natural environment, such a predominance might jeopardize the stability of society. Consequently, I argue that it is necessary to critically assess the engagement of business firms in activities beyond their generic economic operations and, on this basis, to develop measures aimed at reconciling the interests of business (such as favourable regulations and low taxes) and the interests of less powerful members of society (such as social security, labour rights, and consumer protection) in cases where the latter are negatively affected by the former. That is, on the one hand, the principles of the market economy should be harnessed to accomplish the efficient allocation of resources. On the other hand, there is a need to prevent potentially negative effects of business activities, however without impairing the functionality of the economic system, thus balancing economic and social considerations. Secondly, I show that such balancing necessitates the reconsideration of the theory and practice of corporate governance. In a major part of research corporate governance is defined as the set of rules and processes aimed at the protection of the owners of a corporation's shares. This special protection is justified by the assumption that all non-shareowning stakeholders of a business firm are protected by explicit contracts, which are legally enforceable (Jensen & Meckling, 1976; Sundaram & Inkpen, 2004). By contrast, shareholders need to rely on corporate managers to generate a return on their investments. Based on these considerations, the dominant approach to corporate governance, which mainly builds on agency theory (Jensen & Meckling, 1976) and the assumption of the existence of an efficient market for corporate control (Manne, 1965), postulates that any management decision needs to regard the maximization of shareholder value as the ultimate objective. As research has shown, such a narrow focus harbours the danger of negative effects on the natural environment (Rose, 2007) as well as on non-shareowning stakeholders in general (Tirole, 2001) and employees in particular (Ireland, 2005; McSweeny, 2008). I suggest that, besides novel forms of governmental and transnational regulation, the opening up of corporate governance for democratic processes is one way to tackle such problems. In the following section I will summarize the three essays of the dissertation. Subsequently, I will discuss the major contributions and describe avenues for further research.

1.2 Summary of the Three Essays

The first essay, which is single-authored, investigates the potentials and pitfalls of business contributions to the public good. Furthermore, it responds to the call for research on the 'desirability of the mechanisms through which citizens can participate in and even control corporations to ensure that their rights are adequately protected' (Matten & Crane, 2005: 176). This essay primarily builds on the ideas of the economic sociologist Karl Polanyi. He observed that the expansion of the market system based on the principles of economic liberalism has the tendency to treat all factors of production – labour, land, and money – as fictitious commodities, i.e. as commodities which are 'treated as if they had been produced for sale' (Polanyi, 1977: 10), with potentially disastrous consequences for societal stability (Polanyi, 1957). These negative consequences result from disregarding the non-economic prerequisites for the stability of society such as intact social relations and the integrity of the natural environment. Polanyi argues, that – as a response to the threat to societal stability by this commodification – 'society protected itself against the perils inherent in a self-regulating market' (Polanyi, 1957: 76) by means such as trade unions and factory laws aimed at the protection of the factors of production from exclusive domination by the forces of the free market. The conflict between economic liberalism, aimed at the expansion of the principles of free market capitalism, and social protectionism, aimed at the partial protection of the factors of production from the forces of the market, has been termed double-movement by Polanyi. Most prominently, in the post-World War II regulatory architecture economic liberalism was first domesticated by strong welfare states, which aimed at the de-commodification – that is, the partial protection from market forces – of labour (Esping-Andersen, 1990) (albeit to a different degree; see Blyth, 2002). Second, Keynesian economic policies aimed at correcting market imbalances (Ruggie, 1982), thus ensuring economic stability and social security. With increasing levels of governmental debt (see, e.g., Habermas, 1989; Streeck, 2013) governments proved more and more incapable of maintaining a strong welfare state and demand-centred economic policies. Further, with the rise of neoliberalism as a dominant paradigm in public policy (Harvey, 2005) governments became more and more unwilling to pursue these objectives (Crouch, 2011). In this situation, the contributions of business firms to the public good become significant. Business firms always contributed to the common good beyond their genuine societal function of value generation, e.g. through enhanced worker protection and the provision of old age benefits, housing, and schooling. Such engagement is referred to as patronism or welfare capitalism in the early 20th century and as corporate social responsibility (CSR) in the present. With business firms complementing or even substituting governmental contributions to the public good, the question emerges whether the current social engagement of business firms can serve as a practical remedy for the negative effects of economic liberalism. Against this historical backdrop, I show that in the academic discourse on the social engagement of business – in the early times of modern capitalism as well as at the present time – the social engagement of business is, on the one hand, affirmatively conceptualized in accordance with the principles of economic liberalism (see, Porter & Kramer, 2006, 2011). From this instrumental perspective, CSR is regarded as a means to contribute to the generation of profit. On the other hand, from a critical perspective, the social engagement of business is conceived as a means to advance the predominance of business in society to the disadvantage of many stakeholders (Banerjee, 2008; Shamir, 2008), if exclusively accomplished according to economic considerations. However, if the observance of the interests of less powerful actors is guaranteed – ideally on the basis of democratic processes –, CSR can serve as a prosocial countermovement that aims to ameliorate the negative effects of economic activity on society (Scherer & Palazzo, 2007). Acknowledging that all these perspectives are valid descriptions of specific facets of the increasing engagement of business in social issues, I show that CSR can be understood as being shaped by the Polanyian double-movement. That is, through CSR business firms potentially pursue instrumental or prosocial objectives, or even both objectives simultaneously. On this basis I argue that while social engagement by business appears to be an increasingly important contribution to the public good, it nevertheless needs to be under close and continuous scrutiny regarding its positive and negative effects.

This essay makes two contributions. First, I illustrate that both critical (see, e.g., Banerjee, 2008; Shamir, 2008; Scherer & Palazzo, 2007) and affirmative perspectives on CSR (see, e.g., Khanna, Palepu, & Sinha, 2005; Porter & Kramer, 2006, 2011) provide valid – and even complementary – analyses of the role of business in current society. On the one hand, an affirmative perspective on CSR has the potential to elaborate business policies that take into account the broadened responsibilities of business which result from a shift of power between business and governments. On the other hand, critical approaches to CSR are necessary elements of a comprehensive evaluation of the phenomenon of CSR. Such approaches have the potential to highlight problematic aspects such as an excessive concentration on CSR activities that are immediately economically beneficial and the disregard of powerless stakeholders. Second, and based on these considerations, I suggest the Polanyian concept of de-commodification, that is, the partial protection of individuals and the natural environment from market forces, as a normative evaluation criterion for the CSR activities of business firms. Accordingly, it is necessary to guarantee a balance of liberal tendencies in CSR that regard CSR as a means to expand market forces in areas of society hitherto untapped by capitalism (see, e.g., Khanna et al., 2005; Porter & Kramer, 2011), and approaches that regard CSR as a means to fill institutional voids (Jackson & Apostolakou, 2010). More concretely, building on the Polanyian political project that comprises governmental regulation of business as well as the democratic co-determination of business firms (Dale, 2010; Ebner, 2010), I suggest measures – both on the level of the business firm and on the level of regulation – which might be appropriate for reconciling economic and social considerations in the social engagement of business and for safeguarding that business firms constructively interact with society.

The second essay, co-authored with Andreas Georg Scherer and Dorothée Baumann-Pauly, looks at the democratic deficit that results when business firms engage in public policy. Such an engagement consists either in the provision of global public goods and the provision of rights (corporate citizenship) or the direct influence on the political system (corporate political activities), with the aim of furthering business interests. We argue that both types of activities potentially threaten the legitimacy, i.e. the social acceptance, of business firms. This is because in both cases business firms exercise power without any democratic legitimation, i.e. without formal authorization or control. Building on a broad definition of corporate governance that regards corporate governance as structures and processes aimed at balancing the interests of corporations and society (Cadbury, 2003), thus securing the consent of stakeholders to the activities of business (Gomez & Korine, 2005), we examine the implications of these developments for corporate governance. We argue that in different stages in the development of modern capitalism business firms faced different distinct challenges for their social acceptance: autocratic power relations within business firms operating in increasingly democratic environments; the growth of modern vertically integrated corporations; the increasing power of financial markets; the growing importance of knowledge as a production factor; and the increasing engagement of business in public policy under conditions of decreasing power of national governments, a situation which we refer to as post-Westphalian (see, e.g., Falk, 2002). In line with configurational theory (Doty & Glick, 1994; Miller, 1981, 1987; Weber, 1922/1978), we conceptualize several ideal-typical forms of corporate governance that can be regarded as responses to these challenges: familial corporate governance, managerial corporate governance, shareholder- and stakeholder-centred corporate governance, and corporate governance structures that aim at the participation of knowledge workers. We argue that the democratic deficit resulting from corporate citizenship and corporate political activities can be regarded as a relatively novel challenge for the legitimacy and, ultimately, for the survival of business firms. Accordingly, we describe a new form of corporate governance – democratic corporate governance. The main feature of this ideal type is the internalization of democratic processes within a business firm as a means to maintain or re-establish corporate legitimacy. Within the scope of a case study, we trace the development of the governance structures of the cement producer Lafarge since its founding in 1833. We argue that Lafarge, facing many of the challenges described above, implemented elements of the ideal-typical forms of corporate governance. In particular, we show that the establishment of a stakeholder panel in which representatives of civil society organizations meet with Lafarge's executive committee and the CEO can be interpreted as a partial democratization of corporate governance, with the aim to remedy the incapacity of other types of corporate governance to appropriately respond to the challenges of a post-Westphalian business environment.

The first contribution of this essay is the application of the configurational approach to corporate governance. We show how contingent forms of corporate governance can be understood as the response of business firms to contextual conditions. Furthermore, whereas most work in the configurational tradition (e.g. Doty & Glick, 1994; Payne, 2006) regards the financial performance of business firms as the only evaluation criterion for the efficiency of specific structures, we suggest legitimacy as an equally important success factor. Thus it becomes possible to gain a comprehensive understanding of the evolution of corporate governance structures and processes. As the second contribution – linking the academic debates on corporate citizenship, corporate political activities, and corporate governance – we describe the implications of the currently shifting balance of power between business firms and governments for corporate governance.

The third essay, co-authored with Andreas Georg Scherer, examines corporate governance from the perspective of the allocation of risk resulting from business activities. One of the main justifications for the centrality of shareholders in the traditional approach to corporate governance in research and practice is the risk borne by shareholders. Whereas all other stakeholders of a business firm are regarded to be parties to explicit contracts and therefore protected by the law, shareholders need to rely on managers to generate enough returns so that shareholders get a profit after the settlement of all contractual claims vis-à-vis a firm. That is, they are entitled to hold residual claims. Since this profit cannot be guaranteed a priori, they hold a residual risk that is regarded as the justification for the right to appropriate the residual claims. In this essay we argue that the assumption of shareholders as residual risk takers becomes untenable in light of globalization and the associated decline of the regulatory power of nation states on the one hand and the increase in the power of business firms on the other hand. Value chains often reach to areas with low or non-existing labour standards, negative externalities such as environmental pollution matter globally, and business firms acquire immense power by assuming tasks originally executed by democratically elected governments. As a result, more and more stakeholders of business firms are exposed to risks resulting from business activities without legal protection – with negative effects on the legitimacy of business firms and ultimately threatening their survival. As observed by Beck (1992, 1999), this reallocation of risk from the level of society to that of the individuals can be regarded as a main characteristic of contemporary society which is therewith becoming a *risk society*. Business firms produce many risks which are constitutive for risk society (Gephart, Van Maanen, & Oberlechner, 2009). Consequently, the concentration of corporate governance on shareholders seems to be inappropriate in a risk society. We argue that, instead, corporate governance should ensure the protection of all stakeholders who are exposed to the risk that results from the activities of business firms, and who are not sufficiently protected by law. We suggest that the democratization of corporate governance structures along the lines of the principles of deliberative democracy might be a viable way to adapt corporate governance to the conditions of a risk society. Accordingly, civil society organizations should take part in the governance processes of business firms and advocate stakeholders that are negatively affected by the activities of business. We show that stakeholder panels, which are currently being set up in many multinational corporations as fora for the discussion of issues such as pollution and labour standards, can be interpreted as moves towards more democratic governance structures. We explain these developments as attempts by business firms to address risks, which are caused by the business firms and are only insufficiently addressed by regulatory frameworks. By this means business firms can maintain or restore their legitimacy.

As a first contribution, we add to the growing amount of criticism (see, e.g., Blair, 2003; Davis, 2011; McSweeny, 2008) of the shareholder-centred approach to corporate governance. This approach is still dominant in the majority of research (Judge, 2009), in the practice of corporate governance (Davis, 2009), and in corporate governance regulation (Hilb, 2012). We show that the justification of the centrality of shareholders as bearers of residual risk in corporate governance becomes untenable in the light of the centrality of business firms in a risk society. With this line of reasoning we complement the second essay by elaborating a critique of the theoretical underpinnings of the shareholder-centred approach to corporate governance. In addition, we argue that alternative approaches to corporate governance, such as team production theory (Blair, 1995) and a property rights approach to governance (Asher, Mahoney, & Mahoney, 2005), that advocate the inclusion in corporate governance of all stakeholders who have contractual ties with a firm are not able to take into account the unilateral exercise of power of business firms, which is characteristic for global business activities in a risk society. As a second contribution, we show that the democratization of corporate governance might be self-enforcing to some extent. We justify this claim by arguing that, in light of increasing societal sensitivity for corporate wrongdoing and growing resistance against unjust business practices, a partial democratization of corporate governance might be the only means for business firms to maintain or restore legitimacy in absence of functioning regulatory frameworks that partly compensated for the risk produced by business firms. In summary, this essay makes clear that theorizing on corporate governance needs to take into account the changing allocation of risk in the current society. At the same time, we make clear that research on an appropriate handling of risks in a risk society is incomplete without a reconsideration of the role of business in general and the role of corporate governance in particular.

1.3 Discussion and Avenues for Further Research

As an overarching topic, in my dissertation I analyse the implications of a shifting balance of power between public actors (i.e. governments) and private actors (i.e. business firms) both on the level of academic discourse and on the level of the governance structures of business firms. First, I show that a predominance of neoliberal tendencies that aim at the expansion of market forces and a disregard of social protectionist tendencies that aim at buffering society from the detrimental effects of unbridled capitalism are potentially problematic for business firms as well as for society as a whole. Approaches that conceptualize CSR exclusively as a means to generate profits (see, e.g., Mc Williams & Siegel, 2001; Porter & Kramer, 2006, 2011) might hence have a negative effect on the public good (see, e.g., Gond, Palazzo, & Basu, 2009). Rather, with increased power of business in society comes increased responsibility, which needs to be reflected in the approaches that firms formulate for their engagement in activities that are traditionally regarded as the domain of governments. Consequently, in all three essays I argue that a constant scrutiny of the activities of business firms and, on this basis, a balancing of both liberal and prosocial tendencies is necessary to maintain the stability of society at large (in essay one) and to safeguard the legitimacy and viability of business firms (in essay two and three), ideally according to democratic principles.

Second, the issue of corporate control is particularly relevant in the area of corporate governance, where ideas of economic liberalism materialize in a concentration on the interests of shareholders with potentially negative effects for other stakeholders. The potential of democratic processes to domesticate the power of business and to tackle legitimacy problems of firms has been elaborated in the extant literature (Palazzo & Scherer, 2006; Scherer & Palazzo, 2007). Extending this stream of research, the second and the third essay of the dissertation adapt these ideas to corporate governance. Both essays, albeit with a different focus (democratic deficits of corporate activities in essay two and a reallocation of risk in essay three), conceptualize democratic corporate governance as a means to balance the interests of different stakeholders if businesses operate outside functioning regulatory frameworks and governments fail to protect non-shareowning stakeholders. Obviously, a comprehensive democratization of organizational decision-making is not likely to be viable and might even be undesirable. However, one central point of this dissertation is that in cases such as the operation of a business firm outside of functioning regulatory frameworks a partial democratization of corporate governance is one way to avoid unfair treatment of organizational stakeholders and to thus tackle legitimacy deficits of business firms. Even if morally sound behaviour of corporate managers can be expected in most cases (see, e.g., Ghoshal, 2005; Osterloh & Frey, 2004), resulting in a fair treatment of all organizational stakeholders without reference to legal prescriptions, law often guides managerial behaviour in an indirect manner through the creation of social pressure and the shaping of individual preferences (Franck, 2013). Law can thus be regarded as fulfilling a ‘sheep dog’ function (Rock & Waechter, 2001). However, when regulatory frameworks are weak or absent, law is unavailable to fulfil this function. In this case, the partial inclusion of stakeholders in organizational oversight processes might work as an alternative ‘sheep dog’.

Third, essays one and three point out measures for indirectly tackling problematic aspects of business activities by means of regulation. Many multinational corporations are based in countries with relatively strong law enforcement. However, such firms often operate in regions with weak regulatory frameworks, either directly or through intricate global value chains. Domestic law in the home countries of these corporations can prevent or compensate the negative effects of business activities in these regions only to a limited extent. Further, as only states are subject to international law, business firms cannot be sued for the violation of international law. However, domestic law might first mandate governance structures that, e.g., include representatives of civil society on corporate boards. Improved oversight mechanisms within business firms might thus prevent corporate wrongdoing. Second, domestic and international regulation might require CSR activities as well as accountability and transparency measures that enable the public to comprehensively judge business conduct. Such mechanisms aimed at balancing the interests of different stakeholders in an indirect manner are illustrated by the recent proposal for a EU directive requiring large corporations to disclose non-financial information (European Commission, 2013) as well as by the aim of the European parliament to include CSR clauses into all EU trade agreements (European Parliament, 2010b). Even if most emerging CSR policies are not strictly legally binding (Steurer, 2010), these developments indicate that there are more and more incentives for business firms to integrate CSR in their business practices. As a consequence, the considerations of this dissertation on the necessity to balance instrumental and prosocial aspects of CSR as well as the implications of this necessity for corporate governance are becoming relevant for more and more business firms.

The findings of my dissertation give rise to a number of important avenues for further research. First, on the one hand democratic processes have the potential to contribute to organizational legitimacy (Palazzo & Scherer, 2006). On the other hand, inefficiencies could potentially result from a broad representation of stakeholder interests in corporate governance (Franck, 2011; Thompson, 2008). It is of utmost importance to develop concrete suggestions for the design of improved governance mechanisms (Walgenbach, 2011) that take into account the potentials as well as the pitfalls of democratic forms of decision-making in business firms. Such suggestions might build on ideas to design organizations on the basis of cybernetic principles. For instance, considerations of requisite variety in systems for tackling environmental complexity (Ashby, 1956) and the concept of circular organizing as a means to overcome the flaws of strictly hierarchical organizations (Romme, 1999; Romme & Endenburg, 2006) might add to the understanding of the challenges resulting from the increasingly political role of firms, with regard to business in general and to corporate governance in particular. Building on these ideas, new approaches to corporate governance (see, e.g., Gomez & Korine, 2008; Pirson & Turnbull, 2011; Turnbull, 1994) might more effectively address the interests of diverse stakeholders, the specific characteristics and contextual conditions of corporations, and simultaneously minimize inefficiencies that potentially result from rent-seeking behaviour and excessive political bargaining that are characteristic for broad collective decision processes.

Second, future research on business and corporate governance should integrate findings from studies on the democratization of science (Bäckstrand, 2003; McCormick, 2007). This stream of research analyses how social movements contest and reframe scientific knowledge. In the context of business and corporate governance, these insights might suggest concrete forms of cooperation between civil society, business, and governmental and transnational regulatory agencies. Furthermore, they might provide a deeper understanding of the preconditions for and dynamics of a change of dominant perspectives. Such an understanding could facilitate a change of the neoliberal paradigm, which is enduringly predominant in business and public policy (Crouch, 2007, 2011). Finally, as business studies and economics extensively shape social life, a democratization of these streams of research along the lines of the democratic science movement might be desirable in order to guarantee a balancing of the societal forces of economic liberalism and social protectionism already identified by Polanyi. In a similar vein, the integration of findings from research on transdisciplinarity (see, e.g., Pohl, 2008; Wickson, Carew, & Russell, 2006), which calls for a broad participation of stakeholders in research projects as a precondition for socially acceptable research results, might be integrated in research on business and economics with the aim of critically reconsidering current business practices as well as dominant paradigms such as competitive advantage and growth.

A third avenue for further research is the thorough analysis of existing democratic structures and processes in business firms in the context of a changing role of business in society. There are several democratically organized business firms (e.g. Semco in Brasil) as well as cooperatives with different forms and extent of democratic participation – about 9600 in Switzerland alone (Swissinfo, 2013), with Migros as the most prominent example, or the Mondragon cooperative in Spain. What is lacking are comprehensive empirical studies on issues such as the capacity of democratic decision-processes in such organizations to address potentially contradictory demands of firm-internal and firm-external stakeholders and possible discrepancies between declared policies and actual processes. As stated in the latest EU strategy for CSR, the governance and ownership structures of cooperatives might be ‘especially conducive to responsible business conduct’ (European Commission, 2011: 6). Therefore, it is crucial to complement extant research on democratically organized firms (see, e.g., Rothschild & Witt, 1986; Wilkinson et al., 2010) by analysing how such firms design their CSR activities and their relationship to the political system and to what extent they actually succeed in observing the interests of diverse stakeholders.

The current theory of the firm is mainly focused on the interests of shareholders (Davis, 2011). The lessons to be learnt from the findings of this dissertation as well as from the future studies envisaged above might be important building blocks for a theory of the firm that transcends this narrow focus. Such an advanced theory might take into account the changing division of labour and power between governments and business firms (Scherer & Palazzo, 2011; Scherer et al., 2006) and make possible to open firms for legitimate claims of various stakeholders without impairing economic efficiency. There is obvious need to guide the ‘current economic transition in a more humane direction’ (Davis, 2010: 347), and a theory of the firm oriented towards the ideas described above might contribute to this objective.

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2 Embracing Ambiguity – Lessons from the Study of Corporate Social Responsibility throughout the Rise and Decline of the Modern Welfare State

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Abstract

In the work of Karl Polanyi, the negative effects of a self-regulating market economy are described as being limited by societal forces such as the policies of the welfare state. With the decline of the modern welfare state since the late 1970s, social activities of business firms are increasingly regarded as an important complement to or even as a substitute for welfare state policies by a part of the literature. However, and controversially, another stream of argumentation regards these activities as being aimed at advancing the reach of market forces. To fully grasp the ambiguous nature of the social activities of business, in this paper I provide an account of affirmative as well as of critical interpretations of these activities throughout the history of modern capitalism. On this basis, the power of critique to disentangle the diverse motivations which underlie the social engagement of business is highlighted as a condition for facilitating a role of business in society that balances economic and social considerations.

Keywords

corporate social responsibility, critique, Polanyi, welfare state

2.1 Introduction

The relationship between business and society is usually analyzed from the perspective of the market economy, with neo-classical economics as the dominant paradigm. Accordingly, the nation state provides public goods and resolves externality issues, and firms have the clear-cut task of value creation. However, beyond this task, since the advent of modern capitalism and the concomitant emergence of modern business firms, firms engage in social and public issues to a varying degree. In the past such activities have been referred to as patronism or welfare capitalism. The terms for modern forms of corporate social engagement are corporate social responsibility (CSR), corporate citizenship and similar concepts, and will be referred to under the umbrella term of CSR in the following (see Scherer & Palazzo, 2007). Some authors argue that CSR – conceptualized appropriately – is completely compatible with a purely economic role of business (Porter & Kramer, 2006, 2011), since, by contributing to the public good, it provides further opportunities for profit generation. However, despite the lengthy quest for the 'business case for CSR' (Buehler & Shetty, 1976; Orlitzky, Schmidt, & Rynes, 2003), no convincing evidence for the positive effect of such activities on corporate revenues has so far been found (Margolis & Walsh, 2003). Therefore, a fraction of the debate about corporate responsibility regards CSR to be incompatible with the dominant theory of the market, namely neoclassical theory with respect to foundational assumptions about the nature of man, the nature of the market, and the way markets work (Dubbink, 2004). Rather, CSR is conceptualized as an attempt to domesticate economic rationality (see, e.g., Scherer & Palazzo, 2011). More critically, CSR is even regarded as fully embedded in the neoliberal rules and scripts (Shamir, 2010; see also Banerjee, 2007; Kinderman, 2012).

Acknowledging the partial validity of each of these streams of argumentation, this article aims at elaborating a framework that simultaneously allows the consideration of affirmative and critical views on CSR. Obviously, two competing logics are at play within CSR: an instrumental logic with the aim of value maximization as well as 'a prosocial logic that differs fundamentally from narrow self-interest' (Suchman, 1995: 579), as it is aimed at enhancing moral legitimacy and contributing to the public good (Palazzo & Scherer, 2006). Thus, it is obvious that the explanation of CSR needs to be grounded in an approach that simultaneously observes instrumental logic and prosocial logic. Further, to gauge the relevance of CSR for the public good, it is necessary to simultaneously look at CSR and state-based measures, which are traditionally regarded as dealing with the public good (see, e.g., Baumol, 1974).

To this end, the approach outlined in this paper refers to the work of Polanyi (1957), who claims that an expanding self-regulating market has the tendency to affect society negatively. As a reaction, society tends to constrain capitalism. Employing the terminology of Polanyi on the issue of CSR, CSR can either be regarded as pursuing objectives similar to the welfare state (reducing the negative effects of market forces) or as antagonistic to these objectives (furthering of market forces). To avoid a simplistic either/or perspective in the analysis of CSR, I suggest to conceptualize CSR as being simultaneously shaped by the instrumental forces of the market and the prosocial forces of society (see also Levy & Kaplan, 2008). The simultaneous realization of both these forces in CSR can be understood as the intra-organizational materialization of the conflict between the societal organizational principles of economic liberalism and social protectionism characteristic of modern capitalism, which has been termed the 'double movement' by Polanyi (1957). To illustrate the materialization of this double movement on the level of the activities of business firms, I provide an account of affirmative and critical interpretations of the engagement of business throughout the history of modern capitalism and suggest the integration of both perspectives. Thus it becomes possible to critically reflect the ambiguous nature of CSR and to comprehensively grasp the impact of this engagement on the public good. Such a change of perspective seems to be crucial in light of the diminishing capacity of modern welfare states to buffer society from the negative effects of capitalism and the concomitantly expanding engagement in public policy by business firms. On the basis of these considerations, the critique of CSR will be conceptualized as a decisive factor that can contribute to balancing liberal and prosocial tendencies of CSR.

The remainder of this paper is organized as follows. In the subsequent section, the Polanyian view on the potentially destabilizing effects of capitalism on social order and the resulting self-protection of society will be delineated. Next I will describe both the advent of the modern welfare state as a means to reconcile different interests in democratic states – and as the main mechanism aimed at buffering society from the negative effects of capitalism – as well as its retreat since the 1970s. Subsequently, to illustrate the ambiguity of the social activities of business, the co-evolution of these activities and the social policies of the welfare state will be reconstructed from an affirmative as well as from a critical perspective. Thus, the importance of CSR for the public good will be described as varying with the rise and decline of the welfare state in developed countries. In addition, I apply my argument to corporate activity in regions with insufficient social protection. Particularly in these regions CSR activities, such as the protection of human rights, are of eminent significance and business firms wield enormous influence on the public good – for better or for worse. Based on these considerations, the crucial role of critique for revealing socially harmful tendencies in CSR and for inducing an alignment of CSR with the public good will be emphasized. In the concluding section I provide a brief summary and point out avenues for further research.

2.2 The Economy, the State, and the Public Good: A Polanyian Perspective

During the Industrial Revolution in the 18th century it had already become clear that the market economy alone could not provide all the conditions necessary to make markets function. In economic and political theory this problem gained considerable prominence. Even if mainstream neoclassical economics completely disregards this problem, the fact that the long-term negative effects of capitalism have been brought up by authors from diverse traditions in economics and political science demonstrates the relevance of this issue. For example, Schumpeter (1975) explained how capitalism is unstable due to its inherent tendency to destroy the societal conditions that facilitate its existence. In a similar vein, Roepke, one of the founding fathers of the German social market economy, stated that capitalism does not have the capacity to produce its moral foundations, and if these foundations are not otherwise safeguarded, the free market economy as well as the free societies depending on this economic system are doomed to collapse (Roepke, 1958). Polanyi described the need for societal self-protection against the destructive side-effects of the self-regulating system of the market economy, such as growing poverty, inhumane working and housing conditions, and high workplace accident rates (Polanyi, 1957), materializing in different forms such as social legislation and the right to unionize throughout the history of capitalism (Polanyi, 1957). The following considerations mainly refer to the ideas of Polanyi, who depicts the commodification – that is, the complete submission to the laws of supply and demand – of money, land and labour as the precondition for the emergence of the system of a self-regulating market (which he regards as utopian in its pure form, since it ‘could not exist for any length of time without annihilating the human and natural substance of society’ (Polanyi, 1957: 3). Polanyi holds that a self-regulating market system can only function if it treats its constituent components as fictitious commodities, i.e. as commodities which are ‘treated as if they had been produced for sale. Of course, they were not actually commodities, since they were either not produced at all (like land) or, if so, not for sale (like labor)’ (Polanyi, 1977:

10). Such a commodification necessarily disregards the manifold aspects of social life and the embeddedness of economic action in social contexts and, by doing so, can lead to the disintegration of social relationships and to the degradation of the environment, making it a potential threat to societal stability (Ebner, 2010). Whereas more recent approaches (e.g. Granovetter, 1985) regard embeddedness as the influence of social facts on economic transactions, in the work of Polanyi embeddedness means that social relationships are a necessary condition for economic transactions (for a controversial discussion of the Polanyian concept of embeddedness, see Gemici, 2008). Polanyi describes the emergence of the self-regulating market as the reversal of this relationship: in the process of commodification the 'substance of society itself' was subordinated to the laws of the market (Polanyi, 1957: 71). Thereby traditional societies were transformed into market societies that faced the destabilizing effects of market forces.

Thus, according to Polanyi, with the emergence of the self-regulating market, modern society developed the capacity for self-protection aimed at countering the deterioration of social and environmental conditions that result from the dynamics of the self-regulating market. 'While on the one hand markets spread all over the face of the globe and the amount of goods involved grew to unbelievable proportions, on the other hand a network of measures and policies was integrated into powerful institutions to check the action of the market relative to labor, land, and money' (Polanyi, 1957: 76). In Western Europe, '[s]ocial history in the nineteenth century was thus a double movement' (Polanyi, 1957: 76) shaped by the expansion of the capitalist system on the one hand and forces countering the negative effects of this system on the other hand.

2.3 The Emergence and Decline of the Modern Welfare State

To date the social policy of the modern welfare state, i.e. state interventions that aim at furthering the public good (Mäkinen & Kourula, 2012), is regarded as a major mechanism for responding to the dysfunctionalities of unregulated capitalism (Ebner, 2010) described in the previous section. It can be seen as aiming at reconciling the contradictions between market activities and societal requirements (Harvey, 2005) in cases where private and public good do not converge (Dubbink, 2004). In particular, as argued by Esping-Andersen (1990), social policy can be conceptualized as compensating for the inherently destructive nature of the process of commodification of labour, which is a decisive feature of capitalist market societies (Polanyi, 1957).

The disastrous implications of the commodification of labour already became apparent during the early stages of the industrialization, starting in the second half of the 18th century in Great Britain and with some delay in the rest of Europe. Capitalism gained considerable momentum up until the 1920s when the negative aspects of this system became more and more evident. Soaring inflation and its devastating consequences, which posed a severe threat to societal stability, can be regarded as the triggers for the limiting of economic activity by governments. Certainly, the phenomenon of social protection can be traced back to ancient times when 'the family, the church, or the lord decided a person's capacity for survival' (Esping-Andersen, 1990: 34). However, these 'flying buttresses' that prevented the collapse of early capitalism were broken by capitalism itself (Schumpeter, 1975), leaving a void that was progressively filled by the modern welfare state. According to Polanyi, fascism as well as communism were made possible by the devastating outcomes of capitalism and therefore can be interpreted as extreme responses to the unbuffered forces of the market. Before and after World War II, in different areas of the world, specific varieties of welfare states developed, often as responses to labour movements, 'protecting worker's income from market fluctuations … since [g]overnments had to ensure that working-class life escaped the insecurity of the 1920s and 1930s' (Crouch, 2008: 478). As conceptualized by Ruggie (1982), despite differences in the ways they safeguarded domestic stability by buffering the destructive effects of liberalism, these systems jointly contributed to the international order of 'embedded liberalism'. However, whereas in continental Europe comparatively strong and comprehensive welfare states of the 'corporatist' and 'social democratic' type developed, in the Anglo-American areas of the world, the 'liberal' type of welfare state was far less comprehensive (Esping-Andersen, 1996). Characteristics of the relatively narrow focus of the Anglo-American type of welfare state are a very limited unemployment insurance and private responsibility for old-age insurance (Tone, 1997), which became increasingly tied to financial markets (Davis, 2009).

In the United States, the New Deal can be regarded as the start of a systematic welfare state, including industrial workers' right to unionize, the regulation of hours of work and minimum wages (Tone, 1997). By 1950, there was a stable coalition of business and state where 'business received a steady return on investment … and [l]abour gained legitimacy, recognition, institutional stability, and an increasing real wage' (Blyth, 2002: 94). In Europe, based on early steps toward the welfare state, such as Bismarck's social security legislation introduced in Germany in the 1880s, the post-World War II era saw the installation of comprehensive mechanisms of social protection. These provided for old age insurance, sick pay, working time reduction and systems of co-determination.

Both in the United States and in Europe '[e]specially in the decades after World War II, capitalist interests accepted more and more constraints: nationalization, progressive taxation, the regulation of labour standards, the dynamic growth of the welfare state which excluded such major potential consumption areas as health, education and social insurance from the reach of profit-making' (Crouch, 1999: 75).

Since the 1980s, however, this trend has reversed (Hart, 2008). Whereas some of the ideas that constitute neo-liberalism have existed for the last 200 years, since the 1970s they became increasingly central in public policy (Crouch, 2009). The already comparatively limited welfare state in the USA and Great Britain was curtailed. In the USA, due to the growing importance of monetarist ideas in fiscal policy, the principles of Keynesianism were abandoned in favour of strict policies to fight inflation without regard for the adverse effect on employment. Further, increasing deregulation of business in areas such as workplace safety and environmental protection, and the privatization of social security can be regarded as an increasing disembedding of liberalism (Blyth, 2002). With Reagan in the United States, 'welfare provisions had become residual, its unions marginalized, and its divisions between rich and poor had started to resemble those of Third World countries' (Crouch, 2004: 11). Similarly, in Great Britain, since 1979, there has been a massive dismantling of the welfare state and a radical turn towards neo-liberalism (Harvey, 2005).

Also in continental Europe, albeit with some delay, a decline of the welfare state could be observed. This can be attributed to the growing indebtedness of governments and excessive regulation curtailing the capacity of the welfare state (Habermas, 1989) as well as to the rise in favour of market-based solutions, the concomitant reduction of welfare benefits, and the increasing privatization of public services (Crouch, 1999). However, as exemplified by the simultaneity of privatization of pensions and welfare provision and increasing inequality on the one hand and the enduring stability of welfare structures on the other hand in Sweden (Harvey, 2005), the reach of these changes does not come up to the changes in the Anglo-American world (Blyth, 2002).

Despite the different trajectories described above, following Crouch (1999), the development of the welfare state can be regarded as following the shape of a (concave) parabola. This means that nowadays the institutions which were established to counter the negative effects of the market economy are becoming more and more ineffective, amounting 'not just to another wave of economic liberalization, but to a perhaps permanent dismantling of collective capacity to resist liberalization or bind it into and reconcile it with a nonliberal institutional context' (Streeck, 2001: 38). That is, despite the fact that the specific nature of this retreat is far from uniform throughout different countries (Blyth, 2002; Harvey, 2005, Swank, 2005), the retreat of the welfare state in every type of capitalist economy seems to be a universal phenomenon of epochal rather than merely of regional significance (Harvey, 2005).

An extension of the idea of the complementarity of the market forces and social protectionism has been suggested by Crouch (2009). He claims that since World War II two different policy regimes reconciled the uncertainties of the capitalist economy with democracy's need for stability. The first policy regime corresponds to the welfare state. According to Crouch, it could maintain its functions by means of Keynesian demand-centred policy. Since the 1970s, this policy model declined for a variety of reasons. Inflationary tendencies and rising debts made state-based demand-centred public policy more and more unviable. Instead, the private sector itself stimulated demand through credit expansion. However, the recent financial crisis has put an end to this practice of maintaining social order by reconciling capitalism and democracy (Crouch, 2008). Crouch (2009) claims that CSR is a likely successor as a central mechanism for the attainment of public policy goals; however, not without pointing out the potential problems resulting from such a concentration of political power in the hands of corporations. Building on these ideas, I argue that – in the light of a diminishing comprehensiveness of welfare states in developed countries and of weak governments in many developing countries and the concomitant increase of the influence of business firms on the public good – the logic behind CSR essentially needs to reflect the growing responsibility of business firms to mitigate the negative effects of their economic activities. To emphasize the complexity of the forces that are at work in CSR, in the following, I will provide two different interpretations of the role of CSR for contributing to the public good and thus of the relationship of CSR and the welfare state.

2.4 Two Readings of Corporate Social Responsibility

One stream of recent research indicates that CSR can be regarded as a substitute for institutional voids (Jackson & Apostolakou, 2010). Furthermore, the concept of implicit vs. explicit CSR proposed by Matten and Moon (2008) points in a similar direction. Accordingly, CSR in the United States is prevalent in an explicit form, characterized by ‘corporate policies that assume and articulate responsibility for some societal interests’ on a voluntary basis (Matten & Moon, 2008: 409). In contrast, the ‘implicit CSR’ prevalent in Europe refers to the role of corporations in the wider formal and informal institutional setting. Therefore one way to conceive of CSR is as a functional equivalent to the modern welfare state in that its purpose is to mitigate the negative effects of the commodification of labour according to a prosocial logic. From this perspective, in the light of the demise of the modern welfare state described above, business organizations may ‘be the entities of last resort for achieving social objectives’ (Margolis & Walsh, 2003: 296). However, from a less affirmative perspective, CSR can be regarded as a means of business firms to curb regulation (Banerjee, 2007), legitimize economic liberalization (Banerjee, 2008; Kinderman, 2009), and expand capitalism into hitherto untapped societal sectors (Shamir, 2008), thus following an instrumental logic.

To gain a deeper understanding of the forces behind CSR, in the following the development of CSR throughout the history of modern capitalism will be traced. The basis of the following considerations is the strong similarity between social activities of business in an early phase of capitalism and the more recent phenomenon of CSR (Hoffman, 2007; Jones, 2007). From the late 1800s to the 1930s, a lack of governmental measures to buffer society against the negative effects of capitalism was accompanied by the social activities of business. With the emergence of the modern welfare state in the 1930s, many of these activities had become compulsory due to comprehensive welfare state policies. With the rise of neo-liberalism as a dominant guiding idea in the public policy of many developed economies (see Blyth, 2002) since the 1980s, however, the comprehensiveness of welfare states has been diminishing. This development is accompanied by a reinvigoration of social activities of business. To grasp the ambiguous nature of CSR and to illustrate the increasing influence of business on the public good, I will give both a positive and a critical interpretation of the social activities of business. On this basis, it becomes possible, firstly, to recognize the distinctiveness of both instrumental and prosocial orientations of CSR. Secondly, it becomes evident how crucial the role of critique is for revealing the ambiguous role of business practices in the attainment of the public good as well as for providing ‘resources for informed protests and progressive challenges to the operation of corporations’ (Willmott, 2008: 929) in general and to CSR practices in particular.

2.4.1 The Affirmative View on CSR: A Positive Reading of the Social Engagement of Business

Since the early times of capitalism, social activities of businesses were by no means uncommon. Basically, the corporation, as it was then, could be regarded as an institution substituting for the social functions of families (Gomez & Korine, 2008) as industrialization eroded traditional forms of familial support (Polanyi, 1957). The owners of firms assumed the role of a ‘patron’ (Jones, 2007), thereby perpetuating pre-capitalist patterns of dependence and support. On the one hand, these activities can be regarded as being aimed at creating and maintaining conditions necessary for sustained production. Examples include investments in physical (e.g. railroads, canals) as well as in social (e.g. schools, housing) infrastructure (Brandes, 1970; Pollard, 1965). On the other hand, however, as modern capitalism progressively destroyed the pre-capitalist framework of society (Schumpeter, 1975), many of these activities can be interpreted as measures aimed at compensating for the societal ruptures that their operations were causing. American welfare capitalism can be regarded as the prototype of business conducting the functions more recently attributed to the modern welfare state. Whereas such measures were initially motivated by owners or owning families, due to the separation of ownership and control (Berle & Means, 1932) the social engagement of corporations became motivated by the managers of firms. Paradigmatically, concepts such as lifelong employment and welfare capitalism are strongly connected with the phase of managerial capitalism (Davis, 2009). Examples of corporate social engagement range from raising wages (Tone, 1997) to the initial private funding of TIAA (which became the major faculty pension fund in the US) by Andrew Carnegie (Davis et al., 2006) to social and financial security provided by employers on a mainly voluntary basis. In parts of the literature, these activities are received in an unreservedly favourable manner. Accordingly, the blessings of early capitalism in general are emphasized (Hacker, 1954) and the beneficial aspects of social activities of business in particular are stressed (Nevins & Hill, 1957).

With the emergence of the modern welfare state, many corporate social activities became compulsory through legislation (Davis et al., 2006; Jones, 2007). For instance, in the 1930s in the USA the New Deal narrowed the leeway for discretionary social activities of corporations (Tone, 1997). At the time, the government built ‘massive bureaucracies aimed at imposing solutions for social problems from above’ (Brandes, 1970: 147). Indeed, business continued to voluntarily engage in social activities, but predominantly in the form of philanthropic donations based on managerial discretion and values (Buchholtz, Amason, & Rutherford, 1999). Further, employment stability continued to be part of the corporate culture in many large firms (see, e.g., Jacoby, 1997).

With the retreat of governments from functions that have originally been regarded as the task of the welfare state, business can be regarded as increasingly filling the institutional void (see, e.g., Jackson & Apostolakou, 2010). For instance, it has been observed that business firms increasingly assume tasks that were originally executed by the state and engage in global governance, rendering the business firm a political actor (Matten & Crane, 2005; Scherer & Palazzo, 2007). One prominent example for such initiatives is the United Nations Global Compact (UNGC). The members of the UNGC commit themselves to observe a number of principles that cover the areas of human rights, labour, environment, and corruption (Arevalo et al., 2013; Bremer, 2008; Rasche & Kell, 2011). Despite their differences, initiatives such as the UNGC can, in general, be interpreted as efforts to limit the negative externalities of corporate activities, a task originally ascribed to governments (see, e.g., Jensen, 2001). Correspondingly, in the area of theories of CSR Scherer and Palazzo (2011) observe a shift from an instrumental CSR, aimed at the maximization of corporate profits, towards political CSR, aimed at filling regulatory gaps.

Once again, a differentiation between the developments in Great Britain and the United States on the one hand and continental Europe on the other hand is appropriate. Due to the poorer comprehensiveness of the welfare state in Great Britain and the United States, voluntary social contributions by business firms have become common in the form of fringe benefits such as pensions, vacation pay, life insurance, and health care (Tone, 1997) for quite some time.

In Europe too, CSR is becoming more and more widespread. As mentioned by Matten and Moon (2008), this spread of CSR practices can be partly attributed to the decreasing capacity of the welfare states to address issues formerly exclusively dealt with through governmental regulation. Moreover, from an affirmative perspective, the endeavours of the European Union to promote CSR (see e.g. European Comission, 2001) can be regarded as an attempt to harness the capacity of private actors to counter the negative effects of capitalism (Amstutz, 2009), constituting an effort to create a private-public hybrid mechanism aimed at advancing social and ecological objectives (Albareda et al., 2008).

To sum up, despite national differences with regard to the extent and depth of CSR activities, it can be observed that firms increasingly take on tasks that are traditionally regarded as the domain of governments (Matten & Crane, 2005). Thus the distinction between a public sphere of state-led regulation and a private sphere of economic competition is becoming increasingly blurred. With the concentration of governments on the economic goal of growth and the concurrent decline of the modern welfare state, a profusion of interest in CSR can be observed (Roberts, 2003). This development can be interpreted as evidence that business in some cases assumes a role that has traditionally been assigned to state agencies and welfare policies.

Further, in the light of globalized economic activity, it is necessary to consider the fact that multinational corporations that predominantly have their origins in developed countries and emerging economies increasingly operate in countries with only rudimentary welfare systems and insufficient legal security. In these cases, they operate in situations similar to those in early phases of capitalism in developed countries, where there have been no mechanisms in place to protect society from the negative externalities of corporate activity. The fact that a major CSR focus is on the protection of human rights in countries with insufficient rule of law can be regarded as further evidence for CSR functioning as a substitute for social protection.

This brief account of social activities of business that are not directly related to the creation of economic value shows that the tackling of social issues by business firms and their response to market failures is by no means a new phenomenon. Whereas a strong welfare state in the second and third quarter of the 20th century made such activities temporarily compulsory, from an affirmative perspective early welfare capitalism as well as more recent approaches to CSR can be regarded as decisive contributions to the public good. From the perspective of the work of Polanyi, these developments can be interpreted in the following manner: The less comprehensive the provisions of the welfare state, the more ‘beneficial constraints’ (Streeck, 1997) on economic rationality aim at limiting the negative consequences of the commodification of labour and consequently also at safeguarding the viability of capitalism.

2.4.2 The Critical View on CSR: A Less Positive Reading of the Social Engagement of Business

Besides the favourable view on the social engagement of business described in the foregoing section, another interpretation of these developments suggests a more questionable impact of business firms on the public good. Accordingly, welfare capitalism was mainly aimed at preventing labour unrest (Brandes, 1970) and unionization (Bernstein, 1960; Jacoby, 1998), influencing employees according to the moral visions of their employers (Barley & Kunda, 1992), and consolidating the hegemony of business in society (Williams, 1961). Marens (2012) describes welfare capitalism as a means of, increasingly, powerful executives of autonomous large, vertically integrated corporations to 'ameliorate the potentially negative impact of their own autonomy in the interest of social peace and economic efficiency' (Marens, 2012: 61).

In a similar vein several authors picture contemporary CSR as one facet of the increasing societal dominance of neoliberal ideas. For instance, Kinderman (2009) as well as Shamir (2008) describe CSR as a means to curb governmental regulation, thus making CSR not a response to the retreat of the state, but rather one of its causes. O'Laughlin (2008) portrays CSR as an attempt to mask the inequalities produced by business. Kinderman (2012) suggests that CSR needs to be understood not so much as a countervailing force to neoliberal transformation of society, but rather as a product of this development. In his account CSR firstly serves as a remedy for certain social ruptures caused by neoliberalism. Secondly, he regards it as a means to legitimize the instrumental rationality of businessmen in the eyes of society and vis-à-vis themselves. What is central to these accounts of CSR is their critical emphasis of the voluntariness of CSR. As noted by Shamir (2008), this voluntariness can be regarded as one facet of a comprehensive process of 'responsibilization', that is, of an increasing transfer of responsibility from the state to the private sector. In this view, CSR can be conceived of as a product of the 'neoliberal epistemology' that dissolves the distinction between economy and society (Shamir, 2008).

As demonstrated by Boltanski & Chiapello (2006), capitalism tends to incorporate its critique to maintain its stability. Thus, welfare capitalism and CSR can be reconstructed as the adaptation of capitalism to critique or even as a subtle strategy aimed at infiltrating the critique of business practices. Accordingly, Shamir (2010) argues that CSR is an example for the ability of corporations to convert critique into commercial assets. From a Polanyian perspective CSR can thus be interpreted as the expansion of market logic into nonmarket spheres. The ideas of Porter and Kramer, two of the most prominent advocates of an economic approach to CSR, are revealing in this respect. These authors argue that the 'opportunity to create economic value through creating societal value will be one of the most powerful forces driving growth in the global economy' (Porter & Kramer, 2011: 15). More specifically, they claim that their concept of shared value 'resets the boundaries of capitalism' and 'opens up ways ... to expand markets' (Porter & Kramer, 2011: 7). As shown by Madi and Gonçalves (2007), CSR can easily be used as a means that only purportedly contributes to the public good, and actually aims at advancing the commodification of social domains. From this perspective CSR can be interpreted as not so much aiming at a reembedding of economic activity in society but rather as a furthering of the commodification of all societal spheres. Though less explicit than the ideas of Porter and Kramer, the majority of current approaches to CSR follow an instrumental logic that regards contributions of business to the public good as a means for increasing profits (see critically Banerjee, 2007; Scherer & Palazzo, 2011). The filling of institutional voids with the exclusive aim of profit maximization (Khanna et al., 2005; for a critical analysis of this development, see Brei & Böhm, 2011) – as in the case of strategic philanthropy (Campbell & Slack, 2007) – might be a short-sighted approach – a fortiori in developing countries with weak institutions (Banerjee, 2007). If CSR is mistaken for simply another way of strategically shaping society to advance the economic goals of business firms (Reich, 2007), the overall effect on the public good is expected to be rather unfavourable (Gond et al., 2009; Hertz, 2001a).

Summing up, social engagement of business firms is discussed in theory and practice from an affirmative as well as from a critical perspective. Barley and Kunda (1992) observed in their analysis of the alternating orientation of managerial discourse that the opposing societal orientations of 'competition, individualism, and calculative self-interest' (Barley and Kunda, 1992: 385) on the one hand, and a common identity that is bound by common values and traditions on the other hand, has not only been a central motivation for much sociological research, but is even a central motif of Western culture. Due to their inherent ontological incompatibility, a theoretical resolution of the conflict between both orientations is not feasible. If one acknowledges that the discourse on the social engagement of business firms revolves around the same paradigms, a theory of CSR that integrates instrumental and prosocial considerations seems to be out of reach (see, e.g., Donaldson, 2012) and the conflict between both these orientations is likely to continue in the theory as well as in praxis. However, despite their contrary vantage points, both perspectives on CSR and its predecessors have one thing in common: They illustrate that the potential of business firms to exert influence on the public good beyond economic activity varies with the degree of the strength of the institutional frameworks that aim at fostering the public good. What is fundamentally different with these perspectives is the evaluation of this potential. Whereas an affirmative stance towards these developments accentuates the potential of CSR to further the public good, a critical stance regards this potential as deeply problematic due to the potential predominance of economic rationality in CSR. Taking into account the validity and relevance of both perspectives leads to the following question: What are the conditions for realizing the beneficial potential of CSR while avoiding its pitfalls. Therefore, in what follows, I will detail the crucial role of critique – both theoretical and practical – for identifying different motivations of CSR as well as for creating context conditions in which the problematic aspects of CSR can be limited and the beneficial potential of CSR can unfold.

2.5 The Crucial Role of Critique for Making Sense of the Ambiguous Nature of CSR and for Conceiving and Creating Alternatives

Refusing to acknowledge the decisive influence of business firms on society on the grounds of the critical considerations given above appears to be futile (Matten, 2008). With the decline of the modern welfare state and 'privatized Keynesianism', a new regime seems to be necessary to reconcile capitalism with social order. As stated by Crouch (2009), CSR is a likely candidate for this task. I argue that the majority of the present approaches to CSR that follow purely instrumental logics are unsuited for this task. If the 'managerial objective is to improve the overall performance of business by effectively addressing nonmarket issues' (Baron, 2000: 4) instead of contributing to the public good and balancing economic liberalism and social protectionism, such approaches are likely to further the reach of market forces. As shown above, such a predominance has the potential to undermine societal stability and to eventually lead to the collapse of capitalism itself. Instead of such a purely instrumental approach, only a much 'more complex network of obligations' (Marens, 2012: 79) seems to be suited to attain a viable balance between economic and social interests. From the considerations above – on the ambiguous nature of CSR – it follows that one an important basis for such an endeavour is an understanding of the entanglement of instrumentalism and social protectionism in CSR. Such an understanding, in turn, is the requirement for effective intervention, be it in and through academic discourse, or through political processes and activism.

In what follows, I sketch the crucial role of critique in general and of critical management studies in particular for disentangling the different (and often contradictory) orientations of CSR for conceiving theoretical and practical alternatives to the dominance of instrumental approaches to CSR, and for finally overcoming conventional sources of power (Levy & Kaplan, 2008).

Critique has served as an important corrective of capitalism throughout its history (Boltanski & Chiapello, 2006). On the one hand, capitalism to some extent evaded critique by means of decisive changes of practices on the surface while retaining its fundamental orientation. On the other hand, critique in many instances led to the modification of practices with the aim of accommodating concerns (see also Streeck, 1997). From this follows that critique indeed has the potential to influence the course of events and that a critique of CSR is necessary to leverage its beneficial potential.

Following the call of Spicer, Alvesson, and Kärremann (2009) for critical management studies to 'actively and pragmatically intervene in specific debates about management and encourage progressive forms of management' (Spicer et al., 2009: 537), I sketch three aspects of a critique of CSR that takes into consideration the shift of power and responsibility between the welfare-state and business firms: pragmatism, normativity, and the emphasis on potentialities.

At present, only the onset of the crucial non-economic role of private business firms can be discerned. However, a shift of power away from democratically controlled actors towards private enterprises is already evident (Crouch, 2004, 2011; Hertz, 2001b, Matten & Crane, 2005; Scherer et al., 2006). The most salient example of the shifting power relations between public and private actors is the area of global governance (Scherer et al., 2006, 2009). Whereas many nation states remain strong with respect to military power (Harvey, 2005) or with respect to financial interventions in the current economic crisis (Crouch, 2011), in the wake of globalization the power of single nation states to regulate transnational business activities is decreasing. Functional equivalents to such regulation on the global scale are developing, but they still lack the comprehensiveness and bindingness of state regulation, and most likely will never resemble state regulation. Instead, global governance schemes are emerging in which business firms within the scope of their CSR policies, nation states, and civil society engage in regulation (Abbott & Snidal, 2009) and the provision of public goods (Matten & Crane, 2005; Scherer & Palazzo, 2011). This development indicates that reliance on national regulatory agencies and welfare-state policies to buffer the negative effects of economic activity is becoming increasingly futile. Acknowledging this fact, but simultaneously rejecting the assumption of CSR as a purely instrumental strategy that solely aims at the commodification of all societal spheres seems to be a pragmatic stance. Such a perspective might be a practicable point of departure for changing management by pointing to inconsistencies and 'making incremental incisions into particular processes' (Spicer et al., 2009: 550).

Clearly, interventions that aim at advancing the embedding features of CSR require a normative point of reference. However, as observed by Mäkinen & Kourula (2012), current theories of CSR that theorize the shifting division of labour between governments and corporations (see, e.g., Scherer & Palazzo, 2007, 2011; Matten & Crane, 2005) lack a clear-cut conceptualization of the division of social, political, and economic responsibilities in society and therefore also a clear normative point of reference. Thus, following the call of Spicer et al. (2009) for explicit normativity in critical management studies, I propose a Polanyian reading of the welfare state as a guiding principle for a constructive critique of CSR. This is in line with an interpretation of the Polanyian double movement as a corrective to market fundamentalism as realized in welfare states (see, e.g., Dale, 2010; Ebner, 2010; Esping-Andersen, 1996). Applying this perspective on CSR, in times of a weakening of welfare states and the concomitant drawback of a state-based limiting of market forces (for a critical evaluation of the conceptualization of the welfare state as an embedding mechanism, see, Lacher, 1999a, 1999b), fencing off the instrumental logic of economic liberalism alternatively needs to take place on the level of the single business firm. Consequently, CSR might be evaluated against its capacity to promote the ideals of the welfare state (see Midtun et al., 2012) and to counter the disembedding effects of economic liberalism. In this vein, '[CSR] in its highest and best usage … offers a conceptual mechanism for corporate self-control in conditions of institutional failure to control' (Wood, 2008: 162). Yet, since broader social goals are often incompatible with the economic rationality of business firms (Banerjee, 2007; Vogel, 2005; Whelan, 2012), a purely voluntary approach to CSR, endemic in current theory and praxis (Banerjee, 2008), is likely to result in an instrumental drift of CSR. This illustrates the necessity to set up control mechanisms that reach beyond pure voluntarism. In this context, Polanyi's normative emphasis on the centrality of democracy for decommodifying the factors of production (Dale, 2010) is instructive. As described by Ebner (2010), Polanyi's political project may comprise state-based measures as well as the democratic co-determination of business firms and associative self-organization. In the light of the declining comprehensiveness of the modern welfare state and the increasing engagement of business in CSR, the latter two features might provide guidance for conceiving forms of CSR that are viable elements of a novel institutional order that transcends the traditional either/or of public vs. private and instrumental vs. prosocial. These considerations point to the necessity to create accountability and control mechanisms in cases where corporate activities influence the public good beyond their generic economic operations (see, e.g., Matten & Crane, 2005; Scherer & Palazzo, 2007), thus shifting the locus of authority (Levy & Kaplan, 2008) and therewith re-embedding economic activity in society through CSR.

Accordingly, the normative conceptualization of CSR as a countervailing force to liberalism is not only directly relevant for CSR, but also indirectly, as it might be applied to the wider institutional context in which CSR materializes (see, e.g., Midtun et al., 2012; Steurer, 2010 on the issue of governmental CSR policies). For instance, it becomes possible to examine current attempts of the European Union to integrate CSR in its policies, thus scrutinizing the ''messy' micro-processes' (Vallentin & Murillo, 2012: 13) of CSR programs. In the case of the EU strategy for CSR 2011-2014 it becomes conspicuous that CSR-related policies of the European Union on the one hand lean towards disembedding conceptualizations of CSR by referring to the concept of 'creating shared value' coined by Porter and Kramer described above (European Commission, 2011). However, on the other hand, the explicit call for 'specific clauses laying down the right of parties to the agreement to regulate, inter alia, in the areas of protection of national security, the environment, public health, workers' and consumers' rights' (European Parliament, 2011) in future European international investment policy points to the acknowledgement of the need to limit disembedding tendencies of CSR policies. This example illustrates how the ideas of Polanyi might be utilized to thoroughly scrutinize CSR initiatives with regard to their capacity to contribute to the public good.

Whereas these quite general considerations can serve as the basis for the critical reflection on the potentials and pitfalls of CSR, one prerequisite for the effectiveness of critique is the engagement with potentialities rather than a mere condemnation of actualities. Rephrasing Spicer et al. (2009), this requires to ask about the CSR to come, rather than focusing on rejecting the CSR that we currently have. The criteria of pragmatism and normativity can thereby serve as guardrails for conceiving a mode of CSR that is both realizable and beneficial for society. More concrete, it is necessary to conceive feasible means 'to govern the institutional tension between dis-embedding commodification and embedding de-commodification as overlapping moments in the double movement of market-making and market-constraining initiatives' (Ebner, 2010: 41) *within* CSR, both on the level of CSR activities and on the level of the wider institutional context. Concerning the former issue, ideas for novel and more inclusive forms of corporate governance (Pirson & Turnbull, 2011; Scherer, Baumann-Pauly, & Schneider, 2012) as well as further-reaching suggestions concerning the opening of corporations for democratic control (see, e.g., Parker, 2002) are crucial. By these means it becomes possible to consider multiple perspectives and demands in corporate decision processes and to make business firms accountable to society (Valor, 2005). With regard to the latter issue, suggestions to guide and even require CSR practices within the scope of public procurement (McCrudden, 2006) and to link CSR with WTO law (Aaronson, 2007) might pave the way for CSR as a re-embedding corrective to economic activity.

2.6 Conclusion

The described conceptual framework aims at harnessing the concept of the Polanyian double movement both as an analytical tool and as a normative beacon. By this means, the analysis of CSR can take into account the ambiguous nature of this concept. Obviously, what is problematic with a Polanyian perspective on CSR is the fact that the sources of the double movement are somewhat underspecified. Whereas Polanyi describes the historical counter-movement against economic liberalism as a cross-class reaction led by pre-capitalist elites, the sources of prosocial CSR are not easy to spot. However, despite the functionalist underpinnings of the way the double movement is conceptualized, the benefit of this perspective is that it allows for theorizing the counter-measures of society against the effects of an unregulated market (Munck, 2004).

As has been shown, a historical account of CSR reveals that modern business has always contributed to the public good beyond its generic economic activities (and apart from its negative impacts on society and environment). Such contributions to the public good by business can be regarded as following an instrumental logic or as being exercised according to a prosocial logic. As a first contribution, I suggest that both these types of logics can be seen as the organizational equivalents of the societal principles of economic liberalism and social protectionism (and therefore as a scaled-down reflection of the Polanyian double movement). With the weakening of the welfare state in developed countries, with the growing power of multinational corporations, and with the expansion of their activities into areas with only rudimentary institutions, the contributions of business firms to the public good are gaining importance - for better or for worse. If the vital importance of an equilibrium of an instrumental and a prosocial orientation of the activities of business firms is disregarded at the expense of social responsibility, the socially harmful effects of commodification are likely to spread and the stability of social order is at stake.

Throughout the history of capitalism, critique served as an important corrective to the forces of the market. Therefore, as a second contribution, I emphasize the importance of critique as a precondition for identifying and disentangling the different orientations that are at play in CSR, both in theoretical and in practical respect. More specifically, I highlight the value of grasping CSR from a Polanyian perspective for scrutinizing social activities of business. In light of a likely increase of influence of business firms on public policy and a concomitant reduction of the comprehensiveness of the modern welfare states, the Polanyian conception of the welfare state – limiting the disembedding forces of the market on the basis of democratic participation – can serve as an important guiding principle for scrutinizing extant approaches to CSR as well as for conceiving viable forms of the CSR to come.

With these insights, the proposed approach opens the door for research on how the elemental conflict between economic and societal considerations, which Polanyi has shown to be inherent in capitalism, is processed on the level of activities of business firms in general and within CSR in particular. The first task of future research will be to carve out the time and place-specific forces determining the extent of the material and symbolic realization of instrumental and prosocial logic described above, and the interaction between actual organizational decision-making and (scientific as well as societal) discursive representation of these forces. Secondly, it is of the utmost importance to research the suitability of different mechanisms that aim at re-embedding economic activity into society (see Gonin, Palazzo, & Hoffrage, 2012) so that CSR is not exclusively exercised according to an instrumental logic but rather serves as a corrective to the socially harmful effects of the economic activities of business. Research on social movements and the role of civil society as well as the emerging study of governmental CSR policies seem to be important steps in this direction. Thirdly, research in the areas of economics, law, and political science on the grave implications of the increasing blurring of the boundaries between private and public domains resulting from corporate engagement in the social sphere is necessary to understand the transformations which society and economy are currently undergoing. The perspective outlined in this paper aims to contribute to this endeavour by shedding light on the ambiguous nature of CSR, and by formulating basic requirements for a critique of CSR so that this approach adds to the public good instead of advancing the dominance of market forces and economic rationality.

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3 Democratizing Corporate Governance: Compensating for the Democratic Deficit of Corporate Political Activity and Corporate Citizenship

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Abstract

This article addresses the democratic deficit that emerges when private corporations engage in public policy, either by providing citizenship rights and global public goods (corporate citizenship) or by influencing the political system and lobbying for their economic interests (strategic corporate political activities). This democratic deficit is significant, especially when multinational corporations operate in locations where national governance mechanisms are weak or even fail, where the rule of law is absent and there is a lack of democratic control. This deficit may lead to a decline in the social acceptance of the business firm and its corporate political activities and, thus, to a loss of corporate legitimacy. Under these conditions corporations may compensate for the emerging democratic deficit and reestablish their legitimacy by internalizing democratic mechanisms *within* their organizations, in particular in their corporate governance structures and procedures. The authors analyze the available corporate governance models with the help of a typology and discuss the possible contributions of a new form of democratic corporate governance.

Keywords
corporate citizenship, corporate democracy, corporate governance

3.1 Introduction

Throughout the process of globalization, the governance mechanisms of the nation state have lost some of their regulatory powers. This loss is a result of the prevailing global business externalities and the significance of global public goods issues, such as environmental (e.g. global warming and deforestation) and social (e.g. corruption and labor standards) issues and the lack of national government control mechanisms (Kaul, Grunberg, & Stern, 2003; Scherer & Palazzo, 2008a). In addition, a significant part of the world's production is located in countries where there is no rule of law and insufficient or no democratic control over public policy issues. This situation sharply contrasts with the state-centric world order resting upon state sovereignty "that has endured, with modifications from to time to time, until the present" (Falk, 2002: 312) since the peace settlement negotiated at the end of the Thirty Years War in Münster and Osnabrück (Westphalia, Germany) in 1648. Therefore, in the literature, this world order is characterized as 'post-Westphalian' (Cutler, 2001; Falk, 2002; Held et al., 1999; Kobrin, 2001; Santoro, 2010). In the 'post-Westphalian' world, confronted with global economic exchange, governance gaps and weakly regulated businesses, business firms operate under conditions where human rights abuses, social misery, environmental disasters, and corruption prevail. Even though companies are not always the cause of these problems, they sometimes benefit from such conditions and the lack of democratic governance, and thus become complicit with human rights abuses and oppressive or corrupt political regimes. Shell, for example, recently settled the case of the death of Ken Saro-Wiwa, a Nigerian activist from the Ogoni people. Saro-Wiwa was sentenced to death and Shell was accused of complicity as it could have intervened in the process through their engagement in the Niger-Delta region (Wheeler, Fabig, & Boele, 2002).

Many multinational corporations (MNCs) have started to respond to these challenges and assume broader corporate responsibilities, thus engaging in *corporate citizenship* (Matten & Crane, 2005; Scherer et al., 2006; Scherer & Palazzo, 2008b). These companies take part in the new emerging global governance structures where non-state actors such as non-governmental organizations (NGOs), civil society groups, international organizations, and private companies contribute to the regulation of global business and compensate for the insufficient supply of public goods. Together they address issues of public concern, provide global public goods, or fill gaps in regulation (Büthe, 2010; Margolis & Walsh, 2003; Scherer & Smid, 2000; Scherer at al., 2006; Scherer & Palazzo, 2011). Matten and Crane (2005: 173) suggest that companies even assume a state-like role when engaging in corporate citizenship, which is defined as “the role of the corporation in administering citizenship rights for individuals.”

This role is not problematic as long as the corporate political activities are embedded in the institutional structure of the democratic rule of law state, so that corporate action complies with legal rules and moral customs and is sufficiently controlled by democratically elected authorities and procedures (see even Friedman, 1970). We understand democracy as “a self-organizing community of free and equal citizens” (Habermas, 1996: 7) aimed at the attainment of just outcomes of political processes (Habermas, 1998) and the coordination “of collective affairs through their common reason” (Cohen, 1999: 385). Following Habermas (2001a), the authors regard democracy as a precondition for the legitimacy of governments and the rule of law installed and sustained by these. As long as business firms conform with the legal rules created and enforced by legitimate governments, they derive their legitimacy from the democratic processes, which legitimate these legal rules; then and only then ‘legitimization in the market sphere is ‘automatic’’ (Peter, 2004: 1).

In the post-Westphalian world, however, many MNCs operate in locations where state institutions fail (Fukuyama, 2004) and where there are no proper legal frameworks or democratic institutions (Palan, 2003; Peerenboom, 2002; Sands, 2005). Even the regulatory power of democratic states seems to be bound as demonstrated by the growing prevalence of global public goods issues and the limited success of uni- or multilateral agreements, such as the regulation of capital markets in the wake of the financial crisis. Under these conditions corporate legitimacy is at stake. Business firms lose their social acceptance as they allocate or withdraw their resources to public issues at will, or lobby for their economic interests while benefiting from governance failures (Palazzo & Scherer, 2006; Suchman, 1995).

Many authors in international relations and political theory argue that there are new governance mechanisms emerging that follow a new model of governance worldwide. *Global governance* differs from the received national governance model in many respects and partly compensates for the governance gaps in the global economy (Habermas, 2001b; Haufler, 2001; Held et al., 1999). The characteristics of the new global governance include: participation of private actors such as NGOs and private companies in rule formulation and implementation, voluntary engagement in public policy issues, weak enforcement mechanisms such as blaming and shaming, network-like structures, policy field specific institutions, indirect authorization, and lack of democratic accountability.

Various authors have explored the new emerging global order and have analyzed the conditions under which the institutionalization of global governance structures may help fill the aforementioned legitimacy gaps (for an overview see, e.g., Palazzo & Scherer, 2006; Scherer & Palazzo, 2011; Wolf, 2005). The implications for the internal governance structures of business firms, however, have not yet been sufficiently discussed. Therefore, we will build upon that previous analyses and consider what can be done *within* the *corporate governance* structures of MNCs in order to address the lack of democratic control and the apparent legitimacy deficits of corporate involvement in global public policy. Therefore, our analysis does not focus on the macro level of the global economy and the relations between business and society (for such an analysis see Matten & Crane, 2005; Scherer et al., 2006; Scherer & Palazzo, 2007, 2011) but instead emphasizes the meso level of the corporation and its internal organizational structures and procedures. There are different approaches to defining levels of analysis in organization theory (e.g. Hitt, Beasmith, Jackson, & Mathieu., 2007; Klein, Denserau, & Hall, 1994). We regard the demarcation of the subject of this article (i.e. corporate governance structures and processes) from the level of the individual actor on the one side and systemic societal processes on the other side as crucial for our considerations Hence, we refer to the distinction between micro (individual), meso (corporation), and macro (systems) described by Enderle (1996) as appropriate for studies in the field of business ethics and business and society. This analysis follows a recent call by Brown, Vetterlein, and Roemer-Mahler (2010) to bridge the disciplinary and theoretical divide between international relations concerned with the political and social sphere on the one hand and management studies analyzing organizational structures on the other hand.

The authors develop a typology of corporate governance approaches to show that, in the past, corporate governance models were formulated mainly to optimize further the corporation’s bottom line (Scherer & Schneider, 2012). As political actors in global governance structures, however, corporations also need to respond to societal expectations and have to address the legitimacy concerns that their involvement in public affairs may cause (Barley, 2007; Palazzo & Scherer, 2006; Suchman, 1995). Therefore, we suggest that the debates on “Corporate Political Activity” (CPA; Hillman, Keim, & Schuler, 2004), “Corporate Citizenship” (CC; Matten & Crane, 2005; Scherer & Palazzo, 2008b), and corporate governance (CG; Clark, 2004) should be linked in order to outline the kind of democratic corporate governance structures which may help to compensate for the democratic deficit under which MNCs operate in many countries.

The idea is that companies compensate for the democratic deficit of their political environment and the lack of legitimacy of their corporate engagement with public policy by *internalizing democracy*, i.e. by establishing democratic structures and processes in their internal corporate governance structures. In the first part we define our understanding of CPA and CC in the context of globalization and explain the critical role of corporate governance. In the second part we present a framework facilitating the analysis of corporate governance approaches. Based on this framework the authors review the existing corporate governance approaches. Thus we show that the focus of corporate involvement in public policy has broadened over time, driven by contextual changes in the business environment, leading to new challenges for the corporation. Furthermore, we provide reasons for the creation of a new democratic corporate governance model, which may help to address the present challenges. Moreover, we briefly sketch out an empirical case of a corporation's governance structures, which display several attributes of democratic corporate governance. The article closes with a short conclusion and suggestions for future research.

3.2 Corporate Political Activity (CPA) and Corporate Citizenship (CC)

3.2.1 The Political Role of Corporate Citizens

The authors regard CC as well as CPA as specific forms of nonmarket strategies. Nonmarket strategies describe the political behavior of business firms in their nonmarket environments defined as "the social, political, and legal arrangements that structure the interactions among companies and their public" (Baron, 1995: 73; on the concept of "nonmarket" see Baron & Diermeier, 2007; Boddewyn, 2003). Just like CPA, which aims 'to shape government policy in ways favorable to the firm' (Hillman et al., 2004: 837), CC also aims to influence the design and implementation of rules and public policy. However, unlike CPA, CC emphasizes the corporate concern for the public interest. CC specifically describes the political role of corporations in global governance with regard to the direct corporate contribution to the common good, for example, the corporate provision of global public goods (Scherer & Palazzo, 2007; Wolf, 2005) and of basic rights (Matten & Crane, 2005). This view builds on the observation that the regulatory power no longer lies solely with state actors (Habermas, 2001a; Scherer & Palazzo, 2008a). Instead, in the global governance, private business firms along with civil society groups, international organizations, and state agencies provide knowledge and resources to the resolution of public issues.

CC therefore can be distinguished from CPA insofar as it excludes all activities that merely aim to improve the economic position of the corporation in a competitive market. The authors do not argue that it is impossible to create win-win situations in which self-interested CPA such as lobbying (Hillman et al., 2004) or the participation in policy networks (Dahan , Doh, & Guay, 2006) also creates rules that increase the provision and accessibility of public goods. Yet under CC the provision of basic rights and public goods is the primary driver for the corporate political engagement and not a coincidental outcome. Most research on CC focuses on the relation between business and society on a macro level of analysis (e.g. Scherer & Palazzo, 2007, 2008b). Up to this point, however, the implications of CC on a meso level, namely for the design of organizational structures and procedures, have rarely been explored. Existing studies are either limited to the analysis of individual cases (e.g. Baumann, 2009; Leisinger, 2003; Rieth, 2003) or they highlight specific corporate functions such as communication or human resources (HR) (e.g. Scherer & Baumann, 2007; Preuss, Haunschild, & Matten, 2009). In particular, the implications of CC on corporate governance structures have not yet been the subject of systematic theoretical and empirical research (for an exception see Thompson, 2008). However, we consider the rules that govern the top decision level of the corporation as critical for engaging in CC. At the governance level, senior management determines how deeply CC is integrated into the corporation and it has become common knowledge that the role of leadership is essential for driving the implementation of CC throughout the organization (Bowie, 2009; Trevino, Weaver, Gibson, & Toffler, 1999). From an organizational point of view, therefore, it is first and foremost the design of corporate governance structures and procedures that enables or impedes the implementation of CC. The organizational level is also critical for addressing the legitimacy concerns that evolve with the political role of corporations in global governance (Palazzo & Scherer, 2006; Scherer et al., 2006).

3.2.2 Addressing Legitimacy Issues of CPA and CC

The issue of how corporations could reconcile public and private interests without compromising their legitimacy is yet to be resolved (Barley, 2007; Palazzo & Scherer, 2006, 2008). Many corporations influence public policy or take over state-like functions and commit to the resolution of public issues. However, we argue that these companies decide on public policy without democratic entitlement and control. Corporations and their managers lack the legitimacy of democratically elected state representatives (unless state actors pick up good practices of corporations, re-integrate them in democratic processes, and turn them into binding laws and regulations; see, for example, Habermas, 2006; Wolf, 2005). This lack of democratic legitimacy of the "state-like" role of corporations is problematic because it affects public interests. Hence this kind of corporate nonmarket behavior must not be confused with private behavior "that is appropriate in the market place" (Elster, 1986: 111) and that only affects the firm and its contracting partners. In political choice situations, however, companies decide on public issues and deliberately *cause* externalities, meaning they "affect other people" (Elster, 1986: 111) who have no contractual relationship with the company and enjoy (in the case of state failure) no protection by the state authorities. Some scholars have started to specifically address the legitimacy problem of the new political role of corporations. On a structural level, Driver and Thompson (2002), for example, outline how corporate governance structures could be extended by the creation of a "corporate senate," which consists of stakeholders who are typically not represented at the corporate governance level. Stakeholders who are affected or concerned by corporate policies (NGOs, local population, etc.) could oversee and influence corporate decision-making (see also Thompson, 2008).

On a procedural level, Palazzo and Scherer (2006) argue that the establishment of communicative processes between corporations and civil society is a suitable means to increase corporate legitimacy. Building on Habermas' theory of deliberative democracy (Habermas, 1996, 1998), they suggest implementing corporate dialogue processes with stakeholders to produce legitimate solutions. Engaging in dialogue represents one way of exploring different interests and expectations. It creates an opportunity to find common ground and collectively agree on sound solutions that are accepted by all participants and lead to social acceptance and legitimacy.

Political science literature outlines two ways in which alternative legitimacy mechanisms for private actors could be designed. The "positivist" approach distinguishes between input, process, and output criteria of legitimacy (Scharpf, 1999). It transfers the legitimacy requirements of public actors to private actors and describes a set of operational criteria that must be fulfilled for private actors to be considered legitimate (e.g. Flohr, Rieth, Schwindenhammer, & Wolf, 2007; Wolf, 2005). In contrast, the "communicative" approach to legitimacy emphasizes dialogue as the main means of building legitimacy (Habermas, 1996). This perspective is based on the notion that legitimacy is not an attribute of individuals, actions, or institutions that can be objectively observed, but is instead a communicatively constructed concept that is ascribed to individuals, actions, or institutions in processes of social construction (Palazzo & Scherer, 2006).

To achieve organizational legitimacy, corporations have to "pursue socially acceptable goals in a socially acceptable manner" (Ashforth & Gibbs, 1990: 177). Consequently, perceptions determine whether private actors are considered legitimate. In a global environment, it is, however, virtually impossible to achieve a broad consensus on morality (Habermas, 1998). Therefore, merely meeting a list of formal criteria may not be sufficient actually to generate societal acceptance and to legitimize public functions of private actors. Thus, the communicative approach is better suited for shaping perceptions and legitimizing the political activities of private actors in a global environment.

The "communicative framework" proposed by Palazzo and Scherer (2006) aims at legitimizing the rule-making activities of private actors in global governance processes. Their concept builds upon Suchman's typology of organizational legitimacy, which differentiates among pragmatic, cognitive, and moral legitimacy. Palazzo and Scherer (2006) argue that, given the conditions of globalization, neither pragmatic nor cognitive legitimacy is manageable. Pragmatic legitimacy results from the calculations of self-interested individuals who ascribe legitimacy as long as they benefit from the corporation's activities. To ensure continuous approval, companies would need to produce the requested output and possibly manipulate the societal context (e.g. by way of strategic public relations) so that constituencies perceive that they benefit from the companies' activities. Yet corporations might not always have sufficient power and resources to do so. Cognitive legitimacy operates mainly on a subconscious level, based on shared values, norms and beliefs. In light of the pluralization of modern societies, however, such a homogeneous background can no longer be assumed, as values and expectations in a global society will not automatically overlap (Habermas, 1998; Palazzo & Scherer, 2006). Therefore, Palazzo and Scherer (2006) conclude that moral legitimacy will become the main means of gaining organizational legitimacy for corporations. Thus, in this article, we find it more appropriate to define legitimacy according to Suchman (1995) and see it as the result of a social construction process. However, Palazzo and Scherer (2006) argue for more corporate dialogues in a general sense, without focusing on the organizational implications of these dialogues. We will build on these ideas and explore the contribution of various corporate governance models.

3.3 A Framework for the Analysis of Corporate Governance Models

In the following section, the evolution of ideal types of corporate governance will be delineated. Seen from a broad perspective, corporate governance can be defined as being concerned with aligning ”(…) as nearly as possible the interests of individuals, of corporations, and of society” (Cadbury 2003: vii) and thus as securing societal acceptance of corporate conduct (Gomez & Korine, 2005, 2008). The current design of corporate governance structures, however, with its focus on the primacy of shareholders’ voices (see Sundaram & Inkpen, 2004) and the profit objective (Jensen, 2002) seems to represent an obstacle for managing the corporation in a way that is perceived as legitimate under the conditions of a post–Westphalian order (Judge et al., 2008). A critical review of present corporate governance structures is therefore the first step towards improving the chances that corporate political activities, including CC will be accepted (Scherer & Schneider, 2012).

In the CG literature, currently four approaches are most influential: Principal Agent Theory (Jensen & Meckling, 1976; Jensen & Ruback, 1983), Stakeholder Theory (Freeman, 1984; Freeman & McVea, 2001), Stewardship Approach (Davis et al., 1997), and the Team-based Approach (Blair, 1995). We regard these theories as resulting in four distinct *corporate governance configurations* or ideal type models of organizational governance (Doty & Glick, 1994; Miller, 1981, 1987; Weber, 1922/1978). Our framework builds on the *configurational approach* in management theory (Miller, 1981, 1987; Scherer & Beyer, 1998). Conceived as a critique and advancement of contingency theory (Meyer et al., 1993; Miller & Friesen, 1984), the configurational approach regards organizational configurations as ‘…any multidimensional constellation of conceptually distinct characteristics that commonly occur together.’ (Meyer et al., 1993: 1175). The reliable occurrence of common states and processes of organizations and environmental characteristics is regarded as the result of two complementary forces. (1) One force is the *internal cohesiveness* of these organizational features (Miller & Friesen, 1984) resulting from their functional harmony (Miller, 1987). Without an internal fit of organizational structures and processes the organization is likely to disintegrate and fail. (2) The second force is the *selection mechanism* of the environment. Corporations operate in potentially hostile and competitive environments. They have to respond to the challenges of the environment in a successful manner otherwise their survival and continued existence is not possible. As a consequence not every organizational configuration with an internal fit can survive but only those that adapt to the environment.

Unlike contingency theory which advocates one best organizational form for each given environmental status, the configurational approach suggests that, depending on the degree of conflict or heterogeneity in environmental demands and the latitude of structural options, there is a possibility of functional equivalents (Gresov & Drazin, 1997; Merton, 1967). Under conditions of high heterogeneity and high latitude there is more than one structural alternative available that makes it possible for the organization to survive. Instead of describing simple and deterministic cause-effect relationships, the configurational approach aims at a holistic explanation of organizations and their environments by emphasizing mutual influences, complementarity effects, and the capacity of various organizational configurations to secure organizational survival (*equifinality*) (Gresov & Drazin, 1997; Scherer & Beyer, 1998).

The approach outlined in this article builds on this understanding. Accordingly, the authors regard the empirical types of corporate governance as realizations of the elements of one or several ideal types in dependence on features of the organizational environment. By shedding light on the interplay between environmental factors and organizational structures, our perspective adds to a growing body of research aimed at understanding corporate governance from an institutional perspective (e.g. Aguilera & Jackson, 2003; Davis & Useem, 2002; Fiss, 2008; Jackson & Moerke, 2005). However, our reconstruction of ideal types of CG from a configurational perspective contrasts with most contemporary approaches in two ways. Firstly, we do not follow the mainly positivistic understanding of configurations as approximations to real types that are characterized by given structures and predefined cause-and-effect-relationships, an understanding that is endemic in most publications (e.g. Aguilera & Jackson, 2010; Fiss, 2007). Rather, we regard configurations as 'frameworks', i.e. as ideal concept patterns which show possible relationships between individual elements of strategy, organizational parameters, and contextual factors without prescribing these in a set manner (Porter, 1991; Scherer & Dowling, 1995). The second aspect concerns the criteria used to evaluate the success of specific structures. In the majority of the work on organizational configurations (e.g. Doty & Glick, 1994; Payne, 2006) as well as in most research on CG (Zingales, 1998) the financial performance of the firm is taken as the sole evaluation criterion for the effectiveness of the analyzed structures. Applying the configurational approach to the study of CG, we build on a much more comprehensive and context-specific conception of effectiveness. From this perspective, '… effectiveness in the broadest sense involves the accountability of corporate decision-makers and the legitimacy of decisions about their different economic and noneconomic goals and values' (Aguilera et al., 2008: 476). Hence, we define the effectiveness of corporate governance not only in terms of maximization of economic efficiency, but we also take into account the capacity of CG structures to balance various environmental demands and to enable organizational survival by generating legitimacy. Building on this particular configurational view of corporate governance, we (re-) construct ideal types of CG which are stable due to their capacity to safeguard organizational efficiency and at the same time contribute to the legitimacy of a firm in specific historical contexts. However, it must be noted that in many cases the degree of conformance of an organization with an ideal type can only be assessed through in-depth studies. That is, in many cases merely symbolic conformance with an ideal type suffices to simulate conformance with environmental requirements, and therefore secure organizational survival. For instance, this simulation has been shown by Westphal and Zajac (1998) for the adoption of means aimed at the protection of shareholders or by Boiral (2007) for the case of the adoption of the ISO 14001 standard for environmental management.

3.3.1 Three Dimensions to Compare Corporate Governance Models

A recent study that assessed the organizational embeddedness of CC at MNCs (Baumann, 2009; Baumann & Scherer, 2010) identified three organizational dimensions that need to be addressed simultaneously for realizing CC in a way that is perceived as legitimate. The (1) commitment dimension, (2) structural/procedural dimension, and (3) interactive dimension capture the strategic objectives of a corporation (commitment), their internal implementation (structural/procedural) and their ability to integrate stakeholder concerns (interactive). The implementation of one dimension is ineffective without the parallel implementation of the others, as only their interplay guarantees the appropriate definition, management and handling of CC issues. These dimensions correspond with the idea of an ideal-type configurational approach and the pressure towards internal coherence. While commitment, structural/procedural, and interactive dimensions emphasize the critical aspects for managing corporate legitimacy and prescribe certain characteristics, they do not necessarily determine the actual design of the configurations but leave latitude for the emergence of equifinal structures as solutions to environmental challenges (Gresov & Drazin, 1997). Hence, for the purpose of this article, they complement the configurational approach because they specifically highlight the aspects that are relevant for managing corporate legitimacy.

3.3.1.1 Commitment Dimension

The commitment dimension describes the publicly expressed readiness of corporate leaders to integrate issues of public concern in the corporate decision-making process. It also captures the issue of the understanding of corporate leaders, particularly whether they define a societal issue narrowly as a strategic opportunity for the corporations, or broadly as an issue that, due to its complexities, requires a holistic solution.

It has been shown empirically that the commitment of corporate leaders is a critical precondition for the implementation of CC. Embedding CC requires decisions from corporate leaders to align organizational structures and procedures. If the commitment to CC is consistently applied to all aspects of the organization, it should also affect the design of the corporate governance. A commitment can reach from acknowledging the need to weigh up public concerns against corporate objectives to making a concrete proposal about how to ensure the systematic integration of stakeholders that are typically not represented at the board level. To assess empirically the commitment dimension of corporate governance, public speeches of corporate leaders as well as corporate codes of conduct, corporate governance codes, and mission statements can be analyzed. The minutes of shareholder meetings, where board members must justify corporate decisions, are probably particularly good data sources for assessing the commitment level. In addition, the commitment dimension could be cross-checked with third parties. Their assessment of the willingness of corporate leaders to integrate stakeholders in dialogue over critical corporate decisions could verify the corporate statements.

3.3.1.2 Structural and Procedural Dimension

The structural and procedural dimension captures the organizational prerequisites for integrating issues of public concern. This dimension includes structural aspects of the organization, such as the composition of the board (e.g. the role of inside or outside members), as well as procedural aspects, such as the decision-making procedures and the distribution of voting powers at the board level. If internal and external stakeholders that are typically not represented at the board level are made part of decision-making processes, their role could be consultative, participatory, or include voting power. These different types of roles must be outlined in formal procedures, and therefore documents that describe policies and procedures are informative sources for assessing the level of CC embeddedness on the structural and procedural dimension of corporate governance.

3.3.1.3 Interactive Dimension

The interactive dimension includes indicators that assess the degree of interaction with and integration of internal and external stakeholders in the corporate decision-making process. In order to embed CC internally, representatives must be nominated from different departments and hierarchical levels. These representatives must be brought together regularly to ensure that information can travel bottom-up as well as trickle top-down from governance levels. Some companies have for this reason created specific board committees that pay attention to CC issues and oversee the implementation process. Integrating external stakeholders requires knowledge of the stakeholder landscape because, depending on the issue area, different stakeholders are relevant. Mapping the stakeholder landscape and developing stable relationships with stakeholders before crisis points, prepares for constructive interactions. For both the integration of internal and external stakeholders at the governance level the transparency over board documents is a key issue. Access to the board's agenda, planned decision-points, and meeting minutes represents a main precondition for enabling a public debate over critical corporate decisions. Therefore, these documents should be made available to relevant stakeholders. The level of transparency can be assessed by reviewing the flow of information inside of the organization as well as by analyzing the communication between the corporation and relevant stakeholders.

3.3.2 Implications for the Mode of Corporate Engagement in Public Policy

The various corporate governance models differ in how they address the respective governance challenges and how they make use of the available corporate governance structures and processes. As a result they lead to different kinds of nonmarket strategies such as CPA or CC (*mode of corporate engagement in public policy*): personal relationships between business people and politics (e.g. A. Leland Stanford) in the Pre-Industrial CG Model; corporate lobbying for public and governmental support in the Industrial CG Model; corporate lobbying for investor' support paired with investor influence on public policy in the Investor and Stakeholder CG Model; both corporate lobbying and reputation building in the Knowledge and Stewardship CG Model; corporate engagement in global governance and the production of public goods in the Democratic CG Model (see Table 1).

	19th century—1920s *Pre-industrial CG*	1920s—1970s *Industrial CG*	from 1970s *Investor- and Stakeholder CG*	From 1990s *Knowledge- and Stewardship CG*	from 2000 *Democratic CG*
model of reference for corporate governance	pre-industrial society, industrialization and family business	industrial society, mass production, and managerial business	investor society, mass ownership, stakeholder activism, and the market for corporate control	knowledge society, intangible assets, and team based control	global society, politicization and democratization of business
main challenges	lack of managerial knowledge, growth of companies efficiency increase democratic deficit within firms	separation of ownership and control efficiency increase	growing investor influence on corporate decisions efficiency increase balancing of stakeholder interests	integration and motivation of knowledge workers management of intangible resources balancing of various interests legitimacy gaps	post-national constellation (lack of state regulation, pluralism of legal systems, heterogeneity of societal expectations), legitimacy gaps & democratic deficits
commitment level: commitment to issues of public concern	low commitment, dependent on benevolent firm owners (patrons)	low commitment, dependent on benevolent managers (managerial philanthropy)	low commitment (CSR as a "business case", strategic corporate philanthropy)	growing commitment (codes of conduct, corporate volunteering & philanthropy)	high (broad participation in CC initiatives, e.g. UN Global Compact, GRI, SA 8000 etc.; responsible leadership)
structural and procedural level: separation of ownership and control embeddedness of CC	no separation of ownership & control no structural embeddedness of CC	separation of ownership & control no structural embeddedness of CC	separation of ownership & control formal incentives and control mechanisms compliance with the legal minimum dialogue with powerful stakeholders	separation of ownership & control peer control and informal control mechanisms integrity approaches and corporate culture	separation of ownership & control broad organizational embeddedness of CC (e.g. incentive systems, HR policies) formal and informal control mechanisms
interactive level: representation and public debate	no representation of interests, no public debate	board of directors, general meetings no representation of stakeholders, no public debate	"shareholder democracy" stakeholder activism no formal repres. of stakeholders	revival of partnerships, inclusion of knowledge workers on corporate boards	involvement with state institutions, NGOs and civil society groups, representatives on corporate boards
mode of corporate political activity	"robber barons"; family relationships with politics (Rockefellers, Kennedys etc.)	corporate lobbying for public support (e.g. infrastructural investments, subsidies, tax holidays) and low regulations	corporate lobbying and investor relations investor influence on public policy	corporate lobbying reputation building	corporate engagement in global governance and the production of public goods (corporate citizenship – CC)
main approaches and authors		corporate governance theory (Berle & Means)	principal-agency theory (Jensen & Meckling) stakeholder theory (Freeman)	team-based theory (Blair, Osterloh & Frey) stewardship theory (Davis et al.)	corporate citizenship (Matten & Crane) political theory of CSR (Scherer & Palazzo) corporate governance and democracy (Driver & Thomson, Gomez & Korine, Parker)

Table 1: The evolution of corporate governance models and the strengthening of democracy (Gomez & Korine, 2005: 747, modified and extended; Scherer & Schneider, 2012: 83)

3.4 A Typology of Corporate Governance (CG) Models

From an organizational theory point of view, the analytical construction of a typology was chosen over a taxonomy due to the methodological problems related to the empirical configuration research (Dess et al., 1993; Hambrick, 1984; Scherer & Beyer, 1998). In line with the considerations described above, ideal types are not to be regarded as testable hypotheses about specific relationships between organizations and their environment or about the resulting organizational features. Rather, ideal types condense decisive environmental features and appropriate organizational adaptations to these features in a highly stylized manner (see Doty & Glick, 1994; Miller, 1981, 1987; Weber, 1922/1978). Since a typology consists of conceptually derived interrelated sets of ideal types, creating an ideal type of democratic corporate governance will eventually help to measure whether corporations conform more or less to the phenomenon (Doty & Glick, 1994; Kolk & Mauser, 2001: 22). Thus, instead of statistically analyzing a large set of data in order to find common patterns, after the description of ideal types of CG this study will use only one case to highlight the commonalities with the theoretically constructed ideal.

Accordingly, in the following material we conceptualize corporate governance as evolving in several steps, representing ideal types or configurations of corporate governance, which can be regarded as appropriate and consistent responses to the challenges of distinct stages in the development of modern capitalism, thereby securing economic performance as well as societal acceptance (Scherer & Schneider, 2012). In particular we show that in the course of this development process an adaptation of corporate governance to the blurring between the private and public sphere, which is characteristic of the post-Westphalian world, can be observed. This adaptation results in an increasing broadening of the interactive dimension of the ideal types of CG described in the following.

3.4.1 Pre-Industrial CG

Pre-industrial corporate governance can be characterized as an outcome of changing conditions of property in modernizing societies. The emergence of liberal societies based on the values of civic equality, the unlimited right to private property, freedom of contract, and a free-enterprise system made the invention of the corporation as an institution of private property possible. Whereas in liberal societies governmental institutions underwent a transformation towards political enfranchisement and democratization, private business firms were at the turn of the century governed exclusively according to the terms of private contracts and the authority of business owners. However, despite the monopoly of power, the owner was dependent on obedience and acceptance of orders. Safeguarding this acceptance can be regarded as the focus of pre-industrial corporate governance. Acceptance in typically family-owned firms was secured through the principles of durability, moral values, succession and independence (Gomez & Korine, 2008: 90). Consistent with the exclusive concentration of power in the hand of the owner was a potentially low commitment of firms to issues of public concern, depending exclusively on the benevolence of the owners of a firm. Therefore, in structural, procedural, and interactive respect no embeddedness of CC in corporate structures and processes was observable in Pre-Industrial CG. Due to the concentration of power in the hands of the owners of a business, no interaction took place either with regard to the representation of firm-external interests or public debate. Backed by their absolute position of power, owners and owning families engaged in political activities in various ways, such as the 'robber barons' (e.g. John D. Rockefeller or Cornelius Vanderbilt), both by influencing or personally participating in politics (e.g. A. Leland Stanford) (Josephson, 1934). Such activities can be regarded as antecedents of modern organized CPA.

3.4.2 Industrial CG

Industrial corporate governance has its roots in the growth of modern corporations. Due to increasing market size, vertical integration of production, and technologies of mass-production firms grew larger and became more and more complex multiunit enterprises. To secure the efficient administration of organizational transactions within such enterprises, owners transferred power to professional managers (Chandler, 2004). At the same time, a growing demand for capital necessitated the raising of fresh capital by issuing new shares. With these developments a separation of ownership and control took place (Berle & Means, 1932), a structural feature typical for Industrial CG as well as for all following ideal types of CG. In this situation the divergence of interest between owners and managers necessitated the implementation of arrangements to protect shareholders from potential misconduct of managers. These developments resulted in the establishment of corporate governance mechanisms such as corporate boards and public meetings, which represented the first step towards the opening of corporations toward democratic processes (Gomez & Korine, 2005). Beyond the particular group of shareholders, however, other corporate stakeholders continued to be completely excluded from representation within corporate decision-making. With professional managers wielding the ultimate power in corporations, commitment to public issues became increasingly dependent on the benevolence of these managers, who in that respect replaced the powerful owners. Parallel to the professionalization of corporate management the practice of influencing political decision-making became professionalized. In the times of Industrial CG the influence of corporations on political decision-making in favor of corporate objectives – corporate lobbying – grew into a huge industry.

3.4.3 Investor and Stakeholder CG

With the strengthening of mechanisms to protect shareholders with laws as well as with formal incentives and control mechanisms (Fama & Jensen, 1980) on the one hand and the immense growth of financial markets starting in the 1970s (Davis, 2009) on the other hand, corporate governance underwent a further transformation. The rising ideal type of investor- and stakeholder governance is shaped by two developments. The first development is the shift from an industrial and manufacturing based economy to a service-centered post-industrial economy, essentially shaped by finance, visible in increased shareholding, corporate pensions held in stock, and increasing securitization (Davis, 2009). In this “investor society” finance became the all-encompassing paradigm. The model of corporate governance geared to the investor society is principal-agent theory (Jensen & Meckling, 1976). It explains how a public corporation can survive when faced with the potentially opportunistic behavior of managers, namely by implementation of adequate monitoring mechanisms (Daily, Dalton, & Canella, 2003) aimed at achieving maximum efficiency. Further, CG was considered to align corporate governance as closely as possible with market processes (Manne, 1965), thereby maximizing efficiency and value of the firm.

The second development shaping Investor- and Stakeholder CG is the increasing corporate sensitivity to societal processes. The concept of stakeholder management postulated the criticality of ‘myriad groups’ (Freeman & McVea, 2001). This illustrates that societal sensitivity to corporate conduct became increasingly recognized as an environmental selection criterion for business firms. Consequently, in Investor and Stakeholder CG enhancing the responsiveness to the claims of stakeholders was regarded as increasing the probability of survival of a firm.

Despite fundamental differences, both approaches advocate the consideration of specific stakeholders in corporate decision-making for economic reasons and they only differ with regard to their scope. Whereas the shareholder view concentrates on shareholders as the constituency which is critical for organizational survival (Shleifer & Vishny, 1997; Sundaram

& Inkpen, 2004), stakeholder theory assumes that the consideration of a wider range of stakeholders enables the maximization of firm value and thus the long-term survival of a firm (Jensen, 2002; Jones, 1995; Post et al., 2002). Beyond such instrumental considerations commitment to issues of public concern remained low. However, in structural and procedural respect, concern with societal issues increasingly became part of corporate conduct, ranging from efforts to safeguard compliance with the legal minimum to the implementation of formal incentive and control mechanisms to guarantee 'corporate social performance' (Wood, 1991). Therefore firms increasingly developed capacities to conduct social activities and engaged in dialogues with powerful stakeholders. Whereas in managerial governance, power was exclusively held by the management, investor- and stakeholder governance was opening up to external influences in a twofold fashion. Firstly, corporate management became confronted with activist shareholders and increasingly organized fund trustees and advisors (Davis & Thompson, 1994). Secondly, increasing activism and power of a broader range of stakeholders (Spar & La Mure, 2003; Zadek, 2004) necessitated corporate management to engage in dialogue with powerful stakeholders and eventually react to societal demands. Thus, despite the lack of formal representation of non-owning stakeholders in corporate governance, this increase in interaction with these parties in various informal ways is one decisive feature of investor and stakeholder corporate governance. With respect to politics, firms expanded their lobbying, which gained importance to influence policy-making in favor of the interests of firms and investors (Hertz, 2001). Furthermore, the growing practice of investor relations was not only limited to the exchange of information but often rather became a tool to shape the political climate in favor of investor interest (Davis, 2009: 178-182). Corporate political activities in Investor- and Stewardship CG as well as in the previous ideal types of corporate governance have in common that they are destined to be exercised within the regulatory sphere of democratically legitimized governments. Despite the legitimacy of such activities being potentially questionable (Baysinger, 1984), they take place within a 'shadow of hierarchy' (Wolf, 2008: 230) of functioning regulatory frameworks where the threat of governmental regulation is present, making them conceivably legitimate.

3.4.4 Knowledge and Stewardship CG

Whereas in industrial society, production was mostly capital-based, in the emerging knowledge society (Bell, 1974; Stehr, 1994), knowledge as a production factor and therefore knowledge-workers gained importance (Drucker, 1999). As a reaction to this development new conceptions of CG emerged. Defining corporations as teams to which different members contribute specific investments in order to facilitate the collective production of value, team production theory regards the balancing of the interests of the different team members as the foremost objective of CG (Blair, 1995; Lan & Heracleous, 2010). Such an extension of focus is regarded as a suitable means to gain a competitive advantage, which is achieved by motivating workers to invest specific knowledge in the process of team production. The recommendation to include knowledge workers on the corporate board can be regarded as an extension of the level of interaction with stakeholders, even if in this case the emphasis lies on firm-internal stakeholders (Osterloh & Frey, 2006). Just as team-production theory is in part based on the critique of the assumptions of principal-agent theory (Blair, 2003), stewardship theory can be regarded as an attempt to overcome these rigid assumptions (Davis et al., 1997). Criticizing the negative behavioral assumptions of economic theory in general and of agency theory in particular, it advocates the restructuring of governance mechanisms according to the assumption of generally benevolent managerial behavior, intrinsic motivation and the need for self-fulfillment. Based on these insights, commitment to issues of public concern was increasingly seen not only as a way to contribute to the financial bottom line of a firm but also as a means to strengthen the motivation of knowledge workers and bridge the legitimacy gaps resulting from an exclusive concentration of corporate governance on the interests of shareholders. Therefore, in Knowledge- and Stewardship CG the commitment to issues of public concern is growing. For instance, codes of conduct are spreading as a means to ensure that corporate activities comply with legal requirements and also with moral demands beyond the law. Furthermore, corporate volunteering is increasingly seen as a way to enhance job-related skills as well as organizational commitment and job satisfaction (Peterson, 2004) and corporate philanthropy is regarded as a strategic means to enhance corporate reputation. In structural and procedural respect this orientation of corporate governance is implemented in multiple ways. Strongly related to the increasing awareness of individual initiative and integrity are approaches emphasizing the importance of corporate commitment for issues of public concern not only on the level of organizational structures and processes, but also on the level of corporate culture and on the individual level (Paine, 1994).

With respect to political activities, in Knowledge- and Stewardship CG besides conventional forms of CPA such as lobbying and campaign funding CC is increasingly regarded as a means for reputation building to attract employees (Turban & Greening, 1996) as well as a way to signal the high quality of experience goods (McWilliams & Siegel, 2001). With this concern for generating reputation by informing customers, corporations engage in the dissemination of knowledge. Since knowledge can be regarded as a global public good (Stiglitz, 1999), such behavior indicates a first move by corporations towards the provision of a multiplicity of public goods observable in the post-Westphalian world. In this situation, the provision of global public goods is increasingly exercised beyond the reach of democratically legitimized governments. This development can be seen as one origin of crises of corporate legitimacy necessitating the re-conceptualization and democratization of corporate governance.

3.4.5 Democratic CG

The democratization of corporate decision-making is by no means a novel idea (Dahl, 1985; Engelen, 2002; Tead, 1945). Most of the previous approaches, however, concentrate on the participation of workers in organizational decision-making (e.g. Collins, 1997; de Jong & van Witteloostuijn, 2004; Wilkinson et al. 2010). Relating to these considerations, but also taking them a step further, the authors conceptualize Democratic CG as enabling firms to respond to the challenges of the post-Westphalian order.

What is essentially different compared to earlier cases is the mode of corporate nonmarket activity: whereas it was long limited to influencing political decision-making (Hillman et al., 2004; Shaffer, 1995), lately private corporations assume tasks that were originally executed solely by governments (Barley, 2007; Matten & Crane, 2005). Without being democratically legitimized to do so, business firms are confronted with a legitimacy deficit (Palazzo & Scherer, 2006, 2008). Furthermore, in the post-Westphalian world firms are increasingly confronted with legitimacy gaps and democratic deficits resulting from operating in unregulated locations and public policy areas, diverse legal systems and heterogeneous cultural environments.

In the following material we sketch democratic corporate governance as an ideal-typical configuration of organizational features which are adequate responses to the challenges emerging from an increasingly political role of the firm in the post-Westphalian world and the resulting legitimacy deficit. Under conditions of functioning regulatory frameworks business firms derived their legitimacy from conformance with legal rules which are legitimated through democratic processes (Peter, 2004). However, in the post-Westphalian world in many locations these conditions are not available. The integration of stakeholders in organizational decision-making seems to be an appropriate means to restore the fit between societal expectations and corporate activities. Whereas stakeholder approaches are limited to stakeholder consultations, democratic corporate governance goes a decisive step further: it integrates stakeholders in processes of organizational decision-making. Thereby the democratic deficit resulting from corporate political activity and corporate citizenship (Parker, 2002) can be compensated for, and corporate legitimacy (Palazzo & Scherer, 2006) can be safeguarded by *internalizing democracy* within corporations.

The first distinctive feature of democratic corporate governance is the focus on corporate engagement in global governance and the production of public goods, reflecting the new political role of the firm and a distinct approach to nonmarket activities. In response to the resulting legitimacy problems, corporate governance aims at the broad legitimization of corporate conduct through observing the demands of diverse stakeholders. Such commitment to CC is indicated by means of participation in CC initiatives such as the United Nations Global Compact (Williams, 2004). Furthermore, corporate legitimacy is supported through reporting of social and ecological information (Etzion & Ferraro, 2010) as well as by means of third party control and certification (Gilbert & Rasche, 2007). On the individual level commitment to CC is promoted by facilitating responsible leadership (Maak & Pless, 2006) which aims for peaceful and thus legitimate conflict resolution.

In procedural respect, suggestions to transfer principles of deliberative democracy to organizations (Palazzo & Scherer, 2006, 2008) can be regarded as a first step towards the democratization of organizational decision-making in general and of corporate governance in particular with the aim to enhance the legitimacy of corporations without impairing the efficiency of market transactions (Scherer & Palazzo, 2007, 2011). Deliberative democracy is conceptualized as a set of procedural rules aiming at controlling administrative power through discursive processes with civil society (Habermas, 1996). Applied to organizations, potentially autocratic decision-making by one particular group (managers or shareholders) is replaced by broad democratic deliberation, avoiding unfair outcomes and safeguarding the legitimacy of corporate action by moral discourse (see Suchman, 1995; Palazzo & Scherer, 2006). Furthermore, this concept seems to be an adequate paradigm for democratic corporate governance. It helps understanding how corporate decisions can be legitimized through participation of all relevant stakeholders in the process of decision-making. Furthermore, the democratization of corporate governance potentially increases the availability of information for decision-making as well as the information processing capacity within corporations (Deetz, 2007; Gomez & Korine, 2008).

With respect to structure, CC can be embedded in various ways. On all organizational levels commitment to CC can be implemented by adequate incentive systems, formal and informal control mechanisms, and HR policies (Stansbury, 2008; Stansbury & Barry, 2007). On the level of corporate governance, one way to safeguard corporate legitimacy is broad involvement of stakeholders in corporate decision processes (Gomez & Korine, 2008), be it by the appointment of outside directors (Hillman & Dalziel, 2003; Mintzberg, 1984), the creation of an additional corporate board (Driver & Thompson, 2008), or the comprehensive redesign of corporate governance structures (Turnbull, 1994). Such interaction with diverse external stakeholders as well as corporate cooperation with state institutions, NGOs, and civil society groups constitutes the most important feature of democratic corporate governance.

The described features can already be found in many contemporary organizations – implemented with different focuses and to varying degrees, depending on specific contextual requirements. In the described ideal type of democratic corporate governance these organizational features are presented in a condensed manner, helping researchers to better understand current trends in organizations as well as helping managers to identify novel challenges and to eventually find new types of solutions, customized to the specific contexts they are confronted with (see Spitzeck & Hansen, 2010).

3.4.6 The Evolution of Corporate Governance at Lafarge: From Pre-Industrial Corporate Governance to Democratic Corporate Governance

In the following material, the authors trace the development of corporate activities in general and of the governance structures in particular of the multinational corporation Lafarge, a corporation that has over the past century continuously re-designed its corporate governance. We briefly illustrate how this firm in different stages of its development partly corresponds to the ideal types described above. We then show in greater details how the current corporate governance structures show a close resemblance to the ideal configuration of democratic corporate governance as outlined in this article. The authors conclude that this democratization of corporate governance can be interpreted as a response to the challenges Lafarge is confronted with in the post-Westphalian order.

Founded in 1833, Lafarge soon evolved as a major producer of building materials. Managed by the founder, Joseph-August Pavin, and afterwards by his sons, the business was in the first decades exclusively owned and directed by the Pavin family. Due to the prestigious involvement of the firm in the construction of the Suez Canal, Lafarge's business activities and its workforce was growing rapidly. To accommodate the needs of its employees, Lafarge engaged in the provision of facilities for its employees, ranging from housing to schooling and hospitals. In 1889, Lafarge's outstanding social policy was awarded with the gold medal of the Universal Exhibition (Lafarge, 2011a). While these social activities can be regarded as philanthropy they were at this point in time also crucial for ensuring the productivity of the workforce. The social benefits for workers also served as a safeguard against labor unrest, a common problem at the time. In sum, Lafarge's social engagement was quite typical for Preindustrial governance of business firms in the early days of modern capitalism.

Due to the rapid growth in demand for building materials, Lafarge grew to become a major supplier of cement. Increased demand for capital resulted in 1919 in the transformation of the family business into a joint stock company (Barjot, 2005). The board of the company, however, preserved a family majority until 1961 (Barjot, 2009). The increasing complexity and internationalization of Lafarge's operations, led eventually to the hiring of a non-family executive and the professionalization of management (Barjot, 2005) which resulted in a separation of ownership and control. These features point at a partial correspondence with the ideal type of Industrial CG.

A significant indication for the rising importance of stakeholders marked the launch of the so-called "Principles of Action" in 1977. The document comprises a set of humanist values and commitments that all employees of Lafarge should endorse. Through this document, the company not only defines its corporate vision – to become market leader – but also publicly commits to serve all of its stakeholders, namely customers, shareholders and local communities (Lafarge, 2011a). This commitment to serve shareholders as well as stakeholders resembles the ideal type of Investor- and Stakeholder CG. The idea of the company's societal responsibility was strongly expedited by Olivier Lecerf, the Chairman of the board during 1974-1989, which is evidence for the commitment dimension of the CG structure at that time.

Furthermore, Lafarge started realizing that serving societal needs was not only a cost factor but could also potentially help to advance corporate profits. The company, for example, explored ways to use industrial waste as alternative fuel in order to create the ‘business case for CSR’. However, despite of this increasing awareness for societal concerns, the governance structures of Lafarge remained centered on shareholders. In the 1980s, the composition of the governance structures did not include societal actors (the structural and procedural dimension). It also took over a decade until Lafarge committed to work jointly with other companies on societal issues. In 1995, Lafarge supported the creation of the World Business Council for Sustainable Development (Lafarge, 2011a), a first indication for the commitment dimension of their future governance model.

With respect to CPA, the early engagement of a representative of Lafarge in the European Roundtable of Industrialists (Cowles, 1997), a think tank with strong influence on European policy (Corporate Europe Observatory, 2011), provides evidence for the increasing corporate influence on public policy.

Thus, in accordance with the configurational approach explicated above, Lafarge simultaneously exhibits features of Preindustrial CG, Industrial CG, and Investor- and Stakeholder CG. The parallel existence of various governance models can partly be attributed to the company’s paternalistic tradition (Barjot, 2005) that forbids an exclusive focus on the demands of the financial markets and preserves an emphasis on social issues. Further, country-specific influences potentially have decisive influence on the prevalence of specific forms of corporate governance (Bebchuk & Roe, 1999; Jeffers, 2005; for the case of France, see Lubatkin et al., 2005). Today, Lafarge has indeed become the world leader in building materials and it presently operates in 78 countries, many of which have unstable or undemocratic political institutions. Business development is oriented towards fast-growing markets, notably in Asia and in the Middle East. Over 60% of its workforce is employed in emerging countries and in 2010, these countries accounted for 53% of Lafarge’s turnover. Lafarge is also one of the world‘s largest cement producers and the cement industry accounts for approximately 5% of the world’s CO_2 emissions. Lafarge’s current business strategy revolves around two priorities. Firstly, the company plans to continue development on emerging markets, especially in cement. Secondly, it wants to accelerate innovation in sustainable construction and construction systems (Lafarge, 2011b).

Lafarge is thus a truly multinational company and due to its strategic focus on business in emerging markets, it is highly exposed to weak institutional policy settings. These circumstances force the company to position itself in challenging political environments. In early 2010, Lafarge therefore published its *Lobbying Charter*. It documents the company's commitment to openness and transparency when it comes to activities in the public sphere. Lafarge lobbies governments for high environmental, social and technical standards and for strict enforcement of regulations. In 2010, Lafarge's most important public positions were those covering climate change and resources and biodiversity (Lafarge, 2011a).

Due to the environmental impact of the cement business, the company also needs to respond to the concerns of environmental groups. Lafarge has for the past ten years been firmly committed to a policy of reducing its environmental footprint (J.P Jeanrenaud, personal communication, October 25, 2010). For the time period between 1990 and 2010, the company publicly committed to reducing its global net CO_2 emissions per ton of cement by 20%. At the end of 2009, Lafarge had already met its goal and reduced its emissions by 20.7% (Lafarge, 2010a).

To ensure that the company's sustainability commitments are broadly embedded in the organization and routinely advanced through daily business practices, a management system was developed that defines clear key performance indicators as well as incentives for managers to meet these objectives:

> "Sustainable development objectives form part of each manager's personal objectives. The results achieved are evaluated during an annual interview. The manager's bonus is calculated in part on the basis of these sustainable development results" (Lafarge, 2011c).

Advancing sustainability at Lafarge is thus not only the task of a specialized department. All employees are expected to contribute.

Lafarge's environmental commitments have been implemented within the context of on-going partnerships with WWF International (Seitanidi, 2007) and other societal organizations. In 2000, Lafarge became one of WWF's first Conservation Partners. Initially, the company's ambitions for the partnership were rather small. Partnering with a global NGO was seen as a good communication tool (Vilaca, 2010). Over time, however, Lafarge realized that the partnership with the WWF could be precious in various ways. Particularly the WWF's environmental expertise provided guidance in the implementation process to reduce CO_2 emissions (J.P Jeanrenaud, personal communication, October 25, 2010).

The positive development of the partnership with the WWF led to a second partnership that would support Lafarge's engagement in HIV projects (Vilaca, 2010). The company regarded the epidemic that also affected its business units in Africa as a social problem and therefore did not want to partner with medical NGOs only. From 2001 CARE France and Habitat for Humanity both became collaborators in defining the company's HIV strategy (Vilaca, 2009: 187). Both projects demonstrate the company's involvement in a new form of nonmarket strategy that goes beyond self-interested corporate lobbying and emphasizes the corporate engagement in the resolution of global public goods problems.

Based on the experience of these partnerships with global NGOs, and with the company's first CSR report, Lafarge‘s internal steering committee for CSR issues decided to institutionalize its stakeholder relations and suggested the formation of a *stakeholder panel*. This decision initiated a significant change in the structural and interactive dimension of the company's corporate governance (Lafarge, 2010b). What had started as a typical stakeholder dialogue between a multinational company and various civil society groups had now been transformed into a formal feature of Lafarge's corporate governance structures (AccountAbility & Utopies, 2007).

The panel consists of ten experts who Lafarge's CEO calls his "critical friends" (J.P Jeanrenaud, personal communication, October 25, 2010). All members either already had working relationships with specific business departments of Lafarge or were personally recommended by existing partners. Since its inception in 2003, the panel meets biannually with the Executive Committee and the CEO. Preparatory meetings with the WWF take place throughout the year. The objective of the biannual meetings is to critically review the company's progress towards sustainability. The panel discusses emerging, current and ongoing "hot issues" in the context of sustainability and it provides advice on how to improve performance on sustainability issues (J.P Jeanrenaud, personal communication, October 25, 2010). The panel also comments on the content and quality of the company's Corporate Responsibility Report and it also enriched the text of the Lobbying Charter for responsible lobbying (Lafarge, 2011d).

At the end of each stakeholder panel meeting, the group jointly agrees on an action plan that the company must implement. The panel, for example, contributed to drafting

Lafarge's *2012 Sustainability Ambitions* document, a roadmap with 16 operational objectives, ranging from security to industrial health, from persistent pollutants to biodiversity (Lafarge, 2011e). The panel is thus not just an advisory body but is able to make policy recommendations that are morally binding for the company. Mr. Jeanrenaud from the WWF said that the company's commitment to implementing recommendations was critical for the group's willingness to engage in the panel and to continue participating in the panel work over the years.

In 2006, Lafarge created a second panel to help the company to develop its biodiversity strategy. Jean-Paul Jeanrenaud reported that the existing panel could not provide the expertise that the company needed in this specialized area (J.P Jeanrenaud, personal communication, October 25, 2010). This expansion of the institutionalized stakeholder engagement at the board level shows that the original model of the stakeholder panel was fully appreciated by senior management because it had added value to Lafarge's operations. Jean-Paul Jeanrenaud explained that the panel had often served as an early warning system for the company by highlighting issues that civil society organizations regarded as problematic. Being alert to problematic issues, the company could proactively respond to the concerns and address issues before they emerged (J.-P. Jeanrenaud, personal communication, October 25, 2010).

The Lafarge Sustainability Report 2009 contains unedited statements by each panel member. In these statements, the panel members openly comment on the company's achievements and non-achievements and outline the directions for Lafarge's future strategy towards sustainability.

For example, panel member Dr. Frank Rose states:

> "Progress against existing commitments on Persistent Pollutants is on track and the renewed partnership agreement with WWF, which has a particular focus on this area, is welcomed and endorsed by the panel. The panel looks forward to further updates as this program is implemented and, as last year, emphasizes the importance of stakeholder engagement, particularly local communities at cement kiln sites."

The analysis of these comments provides evidence for the deliberative processes that take place at the meetings of the stakeholder panel.

This description of the development of Lafarge's Stakeholder Panel shows that the company adjusted its organizational structures and procedures over time to include outside stakeholders in corporate decision making in order to meet the increasingly pressing and heterogeneous expectations of stakeholders. The introduction of the Panel created a new fit between the company's environment and its organizational design and thus contributed to the legitimacy of the corporation by means of embedding democratic structures and procedures.

The company also actively engages in global governance initiatives which engagement is evidence for their public commitment and part of the commitment dimension of their CG structure. The Lafarge Report 2009 was drafted according to the highest reporting standards of the Global Reporting Initiative (A+ rating) and the company has participated in the UN Global Compact since 2003. Lafarge is also strongly committed to the development of a sectoral approach for change in the field of climate change, particularly through the Cement Sustainability Initiative (CSI; http://www.wbcsdcement.org). Co-chaired by Lafarge's CEO Bruno Lafont, the CSI, an organization of 23 cement producers which collectively account for about one third of the world's cement production, work collectively towards greater sustainability of the industry.

The Lafarge example shows the emergence of a new governance model that has many features of the ideal-type democratic corporate governance model conceptualized in this article. Real cases never perfectly reproduce ideal-types and Lafarge also exhibits facets of other ideal-types than democratic corporate governance. Further research is necessary to analyze in more detail how Lafarge evolved, which features of the described ideal types dominated in which era, and which organizational and environmental factors led to the prevalence or disappearance of specific governance features. Yet, the dynamic adaptation of Lafarge's governance structures to new demands (e.g. from environmental NGOs) as well as the consistency between Lafarge's public sustainability commitments and its internal policies (e.g. HR policies and incentive systems) highlight the configurational characteristics of a new governance model and illustrate that democratic corporate governance is a workable ideal.

3.5 Conclusions

This article closes a research gap by linking the theoretical debates of CC, CPA, and corporate governance. The proposed new perspective provides theoretical guidance for the analysis of the evolution of governance mechanisms and for the design of corporate governance structures in a post-Westphalian world. Following a configurational approach, we conceptualize five ideal types of corporate governance. The respective combinations of a specific orientation of corporate governance and their organizational parameters represent adequate answers of corporations to specific historic context conditions in a stylized way. Before conceptualizing a novel ideal type of corporate governance (democratic corporate governance), we refer to four ideal types of corporate governance already available in the literature: pre-industrial governance as a response to an increasing democratic deficit within firms (from the 19th century to the 1920s); industrial corporate governance as a response to the rise of managerial capitalism and the resulting separation of ownership and control (1920s to the 1970s); investor- and stakeholder CG (from the 1970s) as a response to the increasing influence of financial markets and non-owning stakeholders; and knowledge- and stewardship CG (from the 1990s) as a response to the challenges resulting from new organizational forms and the increasing importance of knowledge as a production factor.

Beyond these contextual conditions, in the 21st century new challenges for corporations are emerging. The regulatory power of nation states is diminishing, transnational equivalents for this power are not available, and the power of corporations is rising. Thus, CPA such as lobbying, and CC, exemplified by an increasing corporate engagement in the provision of public goods, result in a democratic deficit as long as they are not legitimized through operations within functioning regulatory frameworks. To date, these changes are reflected in corporate governance research only to a very limited extent. Therefore, the authors firstly distill a new ideal type of corporate governance (“Democratic Corporate Governance”), condensing organizational parameters, which enable organizations to tackle the democratic deficit, resulting from CC and CPA, by internalizing democratic procedures. Secondly, we develop an analytical tool to empirically study ‘instrumental view’ and ‘political view’ types of conceptions of corporate responsibility (Scherer & Palazzo, 2011). Comparing empirical cases using this tool makes it possible to study the effects of different corporate governance designs on the legitimacy of the corporate engagement with public policy. Using the Lafarge Corporation example, we show that elements of democratic corporate governance can be found in practice as appropriate responses to challenges not addressed by other types of corporate governance. However, more empirical as well as theoretical research is necessary to understand the specific modes of interaction between organizations and civil society, their effect on organizational legitimacy and efficiency, and the effective organizational implementation of commitment for issues of public concern. Furthermore, the analysis of the relationship between Democratic Corporate Governance and the prevalent variety of Investor- and Stakeholder CG as well as the study of factors favoring the orientation of organizations towards specific ideal types of corporate governance are of utmost interest. This article is intended to be a first step towards a better understanding of phenomena only partially explainable by other approaches to corporate governance and eventually might contribute to the redesign of corporate governance structures adequate to the challenges of the post-Westphalian order.

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4 Corporate Governance in a Risk Society

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Abstract

Under conditions of growing interconnectedness of the global economy more and more stakeholders are exposed to risks and costs resulting from business activities that are neither regulated nor compensated for by means of national governance. The changing distribution of risks poses a threat to the legitimacy of business firms that normally derive their legitimacy from operating in compliance with the rules of democratic nation states. However, during the process of globalization the regulatory power of nation states has been weakened and many production processes have been shifted to states with weak regulatory frameworks where businesses operate outside the reach of the democratic nation state. As a result, business firms have to address the various legitimacy challenges of their operations directly and cannot rely upon the legitimacy of their regulatory environment. These developments challenge the dominant approach to corporate governance that regards shareholders as the only stakeholder group in need of special protection due to risks not covered by contracts and legal regulations. On the basis of these considerations, we argue for a democratization of corporate governance structures in order to compensate for the governance deficits in their regulatory environment and to cope with the changing allocation of risks and costs. By way of democratic involvement of various stakeholders, business firms may be able to mitigate the redistribution of individual risk and to address the resulting legitimacy deficits even when operating under conditions of regulatory gaps and governance failure.

Keywords
corporate democracy, corporate governance, globalization, legitimacy, risk

4.1 Introduction

With the power and latitude of firms in a globalized economy rapidly expanding, their actions affect an ever wider range of individuals, such as workers in complex global supply chains, persons affected by pollution or other kinds of negative externalities, although the firms in many cases are not legally accountable to these individuals. Consequently, more and more stakeholders of business firms are individually exposed to risks and costs resulting from the operations of business firms in cases where the regulatory power of national governments is incapable of mitigating or socializing these risks. That is, the harmful consequences of the activities of business firms are imposed on individuals without their consent and without protection through regulatory frameworks: 'the burden of risk migrates from the jurisdiction of institutions to the individualized sphere of personal decision-making' (Mythen, 2005: 130). This individualization of risks beyond the reach of regulatory protection is a major feature of contemporary society, which has been characterized as a *risk society* by Beck (Beck, 1992, 1999). Business firms are an important source of risks in risk society (Matten, 2004; see also Gephard et al., 2009). Therefore, the individualization of risks is a threat to the legitimacy of a firm, i.e. its social acceptance (Palazzo & Scherer, 2006; Suchman, 1995). Since legitimacy is a vital condition for an organization such cases potentially jeopardize the survival of the firm (Meyer & Rowan, 1977).

The dominant approach to corporate governance advocates the primacy of shareholders (Daily, Dalton, & Canella, 2003; Judge, 2009) due to the residual risk borne by shareholders (Easterbrook & Fischel, 1996; Williamson, 1985; see also, critically, Stout, 2002) and the efficiency allegedly accruing from the concentration of corporate governance on the generation of shareholder value (Hansmann & Kraakman, 2001; Jensen, 2002; Sundaram & Inkpen, 2004; see also, critically, Elhauge, 2005). The first aim of this paper is to show that this approach to corporate governance – as well as many alternative approaches – neither adequately consider the risks accruing from changing economic and political conditions of business firms operating in a global environment nor the resulting legitimacy problems of business firms. The second aim is to develop an alternative conception of corporate governance that can better address the individualization of risk by means of a democratization of corporate governance. We extend current research on the inclusion of stakeholders in corporate governance (see e.g. Driver & Thompson, 2002; Gomez & Korine, 2005, 2008;

Scherer, Baumann-Pauly, & Schneider, 2012) in several respects: First, we identify an increasing exposure of individual stakeholders to the risks and costs that emanate from business activities and analyse the incompatibility of this development with shareholder-centered approaches to corporate governance. Second, we elaborate a selection criterion for stakeholders who should be represented in corporate governance. Third, we conceptualize the required democratization – by law and soft law – of corporate governance as a means for governments and transnational organizations to indirectly tackle global governance gaps.

The paper is structured as follows: In the second section, two central justifications of the shareholder-centered conception of corporate governance will be delineated and their appropriateness vis-a-vis the shifting division of power between economic and political actors and the resulting individualization of risk will be explored. In addition, we will discuss alternative approaches to corporate governance regarding their potential to address these issues. In section three, we will argue that a shift in the scope of corporate governance is necessary to appropriately determine which stakeholders need to be included in corporate governance. In the fourth section, we suggest how democratic processes can be implemented in organizations to guarantee a fair allocation of risk and to legitimize corporate power. The approach of deliberative democracy to corporations will be discussed as a possible conceptual foundation of this endeavour. These ideas will be exemplified by referencing the empirical example of stakeholder panels. A conclusion and suggestions for further research complete this paper.

4.2 Challenges for the Shareholder-Centered Approach to Corporate Governance

In this section we show that the shareholder-centered approach to corporate governance is justified by the residual risk borne by shareholders as well as by the socially beneficial effects alledgedly accruing from the maximization of shareholder value. We suggest that both argumentations become questionable due to the changes resulting from globalization and the resulting reallocation of risk from the producers of risk and the societal level towards individuals.

4.2.1 Risk and Efficiency as the Foundations of Dominant Corporate Governance Theory and Practice

The shareholder-centered approach to corporate governance can be traced back to problems arising from the changing relation between ownership and control of businesses, first described by Berle and Means (1932). According to their study, an increase in the number of shareholders of corporations diminished the capacity of individual shareholders to control corporations. Professional managers gained influence and the owners lost the capacity to monitor the behavior of the managers. Assuming utility-maximizing behavior of the managers, shareowners ran the risk of managers utilizing the money supplied to the company to maximize their own utility rather than maximizing corporate value and, thus, the value of shares. Consequently, a control mechanism, which prevented the managers from shirking and misusing their fiduciary function, became necessary (Shleifer & Vishny, 1997). From this perspective, corporate governance can be described as a mechanism aimed at minimizing the risk borne by shareholders, who are regarded as the owners of a firm.

In the course of the advancement of the economic theory of the firm, the conception of corporations was further developed: initially seen as the sum of the invested capital owned by the investors, corporations were redefined as a nexus of contracts (Coase, 1937; Easterbrook & Fischel, 1996) – bringing into equilibrium the conflicting objectives of individuals (Jensen & Meckling, 1976). Whereas most contractual partners such as employees, debtors, and suppliers have well defined claims on a firm and therefore bear no risk due to the enforceability of their contractual claims by legal sanctions, shareholders need to rely on the management to maximize their return by maximizing the firm value, since profit cannot be determined a priori. The relation of owners and managers of publicly traded corporations has been explained by the principal-agent theory (Jensen & Meckling, 1976), highlighting the situation of asymmetric information between shareowners (principals) and managers (agents) and determining the optimal incentives necessary to prevent managers from shirking and thus motivating them to maximize firm value and simultaneously the value of shares. The (residual) risk associated with the uncertainty concerning the extent of the residual claims is regarded as the justification for the shareholders to have the right to appropriate the difference between revenue and cost, namely the residual claims (profit) (Easterbrook & Fischel, 1996; Sundaram & Inkpen, 2004) and therefore an important justification for shareholder-centered approaches to corporate governance (Stout, 2002).

A further justification of the shareholder-centered approach to corporate governance relates to the efficiency alleged to result from the maximization of share value. According to this view, corporate governance focussing on shareholder primacy is justified in the following way: shareholder value is regarded as a single indicator by which shareholders and the market for securities can assess managerial performance (Jensen, 2002). The assumption central to this justification of corporate governance is the view that market-based allocation is most efficient in serving the public interest if extra-economic interferences are minimized (Sundaram & Inkpen, 2004). According to this position, the mechanism of corporate governance remedies the problems resulting from the separation of ownership and control in the most efficient manner by means of the market mechanism. The market for securities assesses corporate performance by means of the share price. Consequently, managers are induced to signal their performance by the maximization of the value of the shares of the corporation they work for. Further, the maximization of the value of a corporation's shares maximizes the overall productivity and value of the firm (Alchian & Demsetz, 1972). Maximal productivity of a firm, in turn, is seen as the optimal contribution to social welfare, assuming that the firm is a value generating entity and the output of efficient firms is higher than the input. Since each unit of surplus (profit) adds to social welfare, the latter is maximized by the maximization of profits (Jensen, 2002). That is, by means of market coordination private profit is aligned with the public interest as long as the maximization of shareholder value takes place within the borders of legal and moral obligations (Sundaram and Inkpen, 2004). Both the residual risk borne by shareholders and the maximization of social welfare through the maximization of shareholder value can be regarded as strong moral justifications for the primacy of shareholders in corporate governance, as the debate on the control of business firms throughout the 20th century illustrates (Berle, 1932; Friedman, 1970; Langtry, 1994).

4.2.2 Globalization, Corporate Governance, and the Individualization of Risk

The dominant shareholder-centered approach to corporate governance relies on the fact that business activities take place within the borders of legal and moral obligations. However, this assumption becomes questionable in light of the diminishing regulatory capacity of nation states and the concomitant increase of power of business firms. In the following, we analyse in detail how these changes, which we regard as important facets of globalization and risk society, challenge the justifications of shareholder-oriented corporate governance theory.

Globalization can be understood as the process of expanding social relations across national borders due to declining costs of transportation, communication, and coordination (Beck, 2000). In the course of this process distances and borders are losing their significance and the scope of action of multinational corporations has expanded considerably (Chandler & Mazlish, 2005; Strange, 2000). Concurrently, despite the state's monopoly of the use of force, the effectiveness of national politics can be doubted in cases where corporate power as well as externality and public goods problems transcend national borders and become global. The increasing influence and power of multinational enterprises on the one hand and the weakening of the power of states on the other hand result in regulation gaps (Beck, 2000; Chandler & Mazlish, 2005; Kobrin, 2001).

In the course of the shift of power between nation states and business firms corporations play an ambiguous role (Scherer et al., 2009). On the one hand, they contribute to the efficient solution of public goods problems and engage in activities that were traditionally seen as the domain of nation states. Private actors such as businesses, NGOs, and civil society groups are engaging in the definition and enforcement of global rules and the production of public goods and thereby contribute to a new form of *global governance* that partly compensates for the diminishing steering power of national governance. Ranging from the provision of infrastructure and education (Margolis & Walsh, 2003), the administration of rights (Matten & Crane, 2005a) to involvement in rulemaking on the global scale and to the generation of soft law (Abbott & Snidal, 2009), corporations take on a political role besides their generic economic role (Beck, 2008; Scherer et al., 2006). On the other hand, societal peace is threatened by the activities of private business firms. Examples are political lobbying benefitting corporations at the expense of the public interest (Barley, 2007), the complicity with human rights violations (Kinley & Nolan, 2008), and externalities such as environmental degradation (Osland, 2003).

The implications of globalization and the increasing political power of business have been reflected in the business literature (Scherer, Palazzo, & Baumann, 2006) but have been considered in corporate governance research only to a limited extent (Scherer et al., 2012). While there is at least some work on the link between corporate governance and CSR (Bhimani & Soonawalla, 2005; Jamali, Safieddine, & Rabbath, 2008), the challenges of globalization for the dominant corporate governance model have barely been addressed (for an exception see Boatright, 2011): the growing incapacity of national governance to regulate global businesses (Beck, 2008), to comprehensively protect stakeholders, or to provide global public goods on the one hand (Hertz, 2001) and the corporate engagement of business firms in public tasks originally assigned to the state on the other (Matten & Crane, 2005a).

The dominant shareholder-centered approach to corporate governance is justified by the residual risk borne by shareholders (Easterbrook & Fischel, 1996; see also, critically, Stout, 2002) as well as by the alledgedly optimal effect of a shareholder-concentration of corporate governance on social welfare (Hansmann & Kraakman, 2001; Sundaram & Inkpen, 2004; critically, see, Elhauge, 2005). However, the diminishing steering capacity of states and the changing division of labor between the economic and the political system challenge these justifications. In the following, we show that the weak enforcement of contracts in many countries, the increasing significance of negative externalities such as global warming, and the involvement of business in the provision of public goods render the dominant conception of corporate governance questionable.

4.2.2.1 Weak Enforcement of Contracts

One reason for centrality of shareholders in the dominant approach to corporate governance is the assumption of the comprehensive protection of a firm's stakeholders (except shareowners) through contracts and the legal system (Sundaram & Inkpen, 2004). Accordingly, the important role the 'legal system and the law play in social organizations, especially, the organization of economic activity' and the availability of 'police powers of the state (…) used to enforce performance of contracts or to enforce the collection of damages for non-performance' (Jensen & Meckling, 1976: 14) are emphasized.

However, with corporations operating beyond the reach of legal enforcement mechanisms, be it in weak states or in undemocratic ones, the option of the legal protection of stakeholders becomes curtailed. In countries where state agencies are either unable or unwilling to protect the legitimate claims of stakeholders the claimants are often exposed to the arbitrariness of powerful corporate actors. The power of stakeholders is further weakend when they have no choice other than to accept the terms determined by the corporate actors. For example, the common infringement of labor rights in global supply chains of major electronics brands (see, e.g., China Labor Watch, 2011) illustrates that even if appropriate labor rights exist, enforcement is weak in many countries. Still more unambiguous is the case of forced labor that accounts for up to 21 million workers of the global workforce (International Labour Organization, 2012; see also Crane, 2013). These examples illustrate that, even if there is some progress in the field of business and human rights law (see, e.g., Clapham, 2006; McBarnet, 2007), the assumption of the enforceability of contracts through the legal systems does not apply to the lifeworld of many workers in developing countries. More generally, they illustrate that many stakeholders lack any protection through functioning legal systems and therefore are directly exposed to risk resulting from the activities of business firms. Even if most multinational corporations are based in countries where the enforcement of contracts is strong, in the wake of globalization these firms potentially have some ties with countries where this assumption does not hold. Hence, the problem of weak enforcement of contracts between business firms and their stakeholders is of global significance.

4.2.2.2 Negative Externalities

A further aspect of the limited capacity of many states to enforce laws relates to externalities such as environmental pollution (Beck, 1992). Within the constellation of national economies negative externalities could to some extent be limited or compensated for by public policy and by means of law. However, this option is often unavailable where no or only weak enforcement mechanisms exist (see above). Banning or preventing negative externalities by means of taxation (Pigou, 1932) as well as proposals for the internalization of externalities by the allocation of property rights (Coase, 1960) are only partially viable, since contractual obligations between stakeholders and firms cannot always be enforced. Due to the transnationality of many problems of externalities caused by corporations, as in the case of climate change and toxic emissions, and due to undeveloped cross-border regulation (Bradley et al., 1999) specific groups of stakeholders or even all of humanity are increasingly exposed to risks resulting from externalities generated by corporations, without the immediate chance of legal protection or compensation (Rockström et al., 2009).

4.2.2.3 Public Goods

Strongly interrelated with the described developments is the expanding power of business in general and of multinational enterprises in particular. Firms provide public goods such as education and infrastructure; they engage in the administration of rights (Matten & Crane, 2005a); they provide public security services (Elms & Phillips, 2009); and they participate in global governance through the formulation of international standards (Scherer et al., 2006), e.g. in areas such as labor rights and environmental protection (Haufler, 2001). These examples demonstrating the engagement of corporations in the provision of public goods indicate that corporations exert significant power (Coglianese, 2007), which in many cases equals or even exceeds the power of state actors (Beck, 2008). Whereas in democratic constitutional states power exercised by the state can be controlled by democratic processes, on the global level corporate power is often uncontrolled. In such situations individuals become exposed to corporate power without sufficient democratic authorization and control of corporate activities and run the risk of unjust treatment.

4.2.2.4 The Individualization of Risk

In states subject to democratic rule of law public authorities rely on their monopoly in the legitimate use of force. All stakeholders of a firm – except for the shareholders – are assumed to be parties in explicit contracts that are enforceable by means of legal sanctions or to be protected by law and regulations (Sundaram & Inkpen, 2004). The state authorities secure compliance with regulations and contractual arrangements and either allocate the costs of negative externalities to their producers or to the society as a whole. As the sole providers of public goods, public authorities are controlled democratically and thereby misuse of power is largely prevented. Furthermore, due to its democratic entitlement and control, this exercise of power by state authorities is regarded as legitimate. The democratic state system acts as a mechanism for both minimizing and mitigating risk by limiting and socializing potential costs for the single citizen and for generating legitimacy for the use of power. Under conditions of globalization, due to insufficient state regulation and weak enforcement, many risks resulting from corporate action can no longer be mitigated by national governance and therefore are becoming more of a threat to individuals who are increasingly directly exposed to the harmful consequences of corporate activity. Besides shareholders, other stakeholders need to be regarded as bearing residual risks (see, e.g., Blair, 2003; Boatright, 2011). In other words: the risk becomes individualized (Beck, 1992). The individualization of risk resulting from business activities can be regarded as a notable facet of a broader societal dynamic characterized by an increasing significance of man-made risks that can only insufficiently be tackled by regulatory frameworks. To capture these developments, Beck coined the term risk society (Beck, 1992).

The re-allocation of risk from the risk-producers and the societal level to the individual undermines the assumption of shareholders as the sole bearers of the residual risk. Further, the contribution of shareholder-centered corporate governance to social welfare needs to be reconsidered. Jensen (2002: 246) explicitly relies on '… the government in its rule-setting function …' to create the conditions necessary to resolve externality problems and admits that maximization of shareholder value does not maximize social welfare when externalities exist. The incapacity of many governments to enforce contracts between stakeholders and firms, to limit or socialize negative externalities, as well as the increasing power of business firms to unilaterally decide on matters of the public good can be regarded as evidence for the incongruence between firm-level efficiency and social welfare (see also McSweeny, 2008). By challenging two important justifications of shareholder-centered corporate governance we expand the major current moral criticism of shareholder-centered corporate governance that relates to the concentration of control in the hands of shareholders (Boatright, 2004).

4.2.3 Legitimacy Problems of Corporate Governance

In this section we argue that the changed allocation of risk as well as the weakening link between firm-level efficiency and social welfare pose a severe threat to the legitimacy of firms and identify these developments as a challenge for the shareholder-centered approach to corporate governance. Legitimacy, as defined by Suchman (1995: 574), 'is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions'. Organizational legitimacy can be based on three sources (Suchman, 1995): (1) the perceptions of beneficial outcomes from the organization and its behavior (pragmatic legitimacy); (2) the organization's compliance with unconscious, taken-for-granted societal expectations (cognitive legitimacy); or (3) a moral judgment that is based on an argumentative process (moral legitimacy) in which it is judged discursively whether an activity is 'the right thing to do'.

Under conditions of a functioning regulatory framework the legitimization of business firms in the market sphere is regarded to be 'automatic' (Peter, 2004: 1) due to their contribution to social welfare (pragmatic legitimacy) and their compliance of business with official rules (cognitive legitimacy). However, as soon as the risks produced by a business firm are no longer limited or mitigated by regulatory frameworks, individuals exposed to these risks might suffer a loss in individual welfare. Further, such cases are often uncovered by NGOs, civil society groups or activists (Spar & La Mure, 2003; den Hond & de Bakker, 2007). Subsequently, information about corporate wrongdoing and critique can spread through media and the new communication technology instantaneously, and corporate legitimacy can be questioned globally, since a reduction of individual welfare of specific stakeholders of the firm might be regarded as a threat to social welfare by a concerned global public. Both developments can lead to the questioning of the legitimacy of this firm. That is, pragmatic and cognitive legitimacy are becoming less reliable sources of corporate legitimacy. For this reason moral legitimacy is becoming more relevant (Palazzo & Scherer, 2006).

Several authors emphasize the importance of corporate governance for the generation of organizational legitimacy. Taking a narrow view, corporate governance can be regarded as one mechanism legitimizing a corporation through the appointment of a corporate board (Hillman & Dalziel, 2003). Taking a broader view, corporate governance can be conceived of as a set of rules aimed at reducing business risks and thus as a guarantee mechanism (Gomez & Korine, 2008). By means of proper corporate governance, a corporation signals to potential shareholders that it practices sound risk-control. Thus corporate governance enhances the trust of the shareholders in the corporation and minimizes potential transaction costs resulting from the collection of information about risks for investments. Building on this definition, we regard corporate governance as a mechanism that signals the ability of a corporation to control and limit risks for stakeholders and thus contributes to organizational legitimacy.

The dominant shareholder-centered approach to corporate governance, which is adapted to the conditions of the pre-globalization era, neither takes into account the individualization of risk nor the incongruence between shareholder value and social welfare. Therefore, this approach to corporate governance is no longer justified by the moral considerations outlined above and is becoming less effective in contributing to organizational legitimacy. Rather, due to its disregard of the negative effects of business activities (Tirole, 1999), it potentially undermines corporate legitimacy. Therefore, the question is whether alternative approaches to corporate governance are available which have the potential to consider the risks borne by stakeholders of a business firm and thus to secure organizational legitimacy.

4.2.4 In Search of New Principles: Alternative Perspectives

Contesting conceptions of the purpose and objectives of a corporation and of the appropriate focus of corporate governance have been discussed for decades (Berle, 1932; Clark, 1916; Dodd, 1932; Friedman, 1970). With the aim of finding corporate governance mechanisms to cope with the challenges of risk society, in the following we discuss the most influential alternative approaches to corporate governance (see also Gomez & Korine, 2005, 2008;

Scherer et al., 2012) with regard to their capacity to take into account the shift of risk towards stakeholders.

One attempt to modify corporate governance is *team production theory* (Blair, 1995). As described above, the dominant approach to corporate governance has been conceptualized to overcome the principal-agent problem that is seen as threatening the efficiency of a corporation defined as a nexus of contracts. The core argument of team production theory is based on the increasing importance of implicit contracts and the resulting shift of risk towards stakeholders, particularly the employees. They become risk-bearers by (in part irrevocably) investing firm-specific skills in a team production effort – the firm –, thereby contributing to value creation, without proper protection through explicit contracts. Consequently, team production theory aims at motivating team members to actually contribute to the process of value creation as well as increasing the amount of information available for decision-making at the board level through participation of employees or knowledge workers (Osterloh & Frey, 2006).

However, regarding the increasing importance of negative externalities, team production theory is constrained by the definition of organizations as teams and the resulting focus on team members. From this it follows that external stakeholders such as individuals and groups affected by corporate action who do not make some kind of investment with which they voluntarily enter into a bilateral relationship with a firm cannot be regarded as team members. According to team production theory, risk imposed on these stakeholders by a corporation cannot be considered within corporate governance.

In line with the theory of team production, *stewardship theory* (Davis, Schoorman, & Donaldson, 1997; Donaldson & Davis, 1991) is based mainly on a critique of the dysfunctionalities of principal-agent theory, the framework that constitutes the shareholder primacy view. Instead of regarding managers as opportunists, stewardship theory assumes that the objectives of managers and shareholders correspond in general. Accordingly, stewardship theory postulates that governance structures that do not constrain the activities of managers motivate managers to maximize shareholder value. One advantage of stewardship-theory lies in its emphasis on integrity of managerial decision-making. However, stewardship theory seems to be unsuited to respond to the challenges corporations are confronted with in the risk society. Being centered on shareholders as the central group of corporate governance, the reallocation of risk from the risk-producers and the societal level to individuals will only be taken into account if this issue is taken into consideration by corporate managers. However, a conflict between the interests of corporate shareholders and stakeholders occurs (Friedman, 1970) as soon as the consideration of risks for stakeholders conflicts with the financial interests of the shareholders.

The concept of *stakeholder democracy* (Matten & Crane, 2005b), which can be regarded as an extension of stakeholder theories (Freeman, 1984; Freeman et al., 2010), emphasizes the importance of democratic participation in corporate decision-making. According to Gomez and Korine (2005, 2008), corporate governance can be regarded as a mechanism to secure the consent of the individuals governed by corporate actions, e.g. all stakeholders. The authors suggest that the democratization of corporate governance is a means to achieve the consent of the stakeholders of a firm. Therefore, stakeholder democracy has the potential to take into account the interests of all stakeholders affected by the reallocation of risks and to thus maintain or restore the legitimacy of business firms.

Summing up, dominant corporate governance theory, team production theory, and stewardship theory all have a limited focus on specific stakeholder groups and therefore lack the capacity to appropriately take into account the reallocation of risks. In contrast, suggestions to integrate stakeholders into organizational decisionmaking directly aim at internalizing democratic processes within the boundaries of the corporation. Such openness to discourse and external control potentially allows to extend the focus of corporate governance beyond those stakeholders immediately involved in corporate value creation to include all stakeholders affected by risk resulting from corporate action, be it risk resulting from insufficient enforcement of contracts, from negative externalities, or from corporate provision of public goods. By submitting them to democratic control, it becomes possible to ensure that organizational decision processes take into account the changed allocation of risks and enable a concurrent resolution of conflicts between a corporation and its stakeholders.

4.3 From Contract to Social Connectedness: Readjusting the Scope of Corporate Governance

In principle, stakeholder democracy has the flexibility to take into account the reallocation of risks that characterizes risk society by including stakeholders in corporate decision processes and to thus compensate for the loss of corporate legitimacy. However, this flexibility makes it necessary to determine (1) which stakeholders are exposed to risk resulting from the activities of business firms and therefore need to be included in organizational decision-making and (2) how the conflicting interests resulting from this reallocation of risk can be reconciled in order to constitute or maintain the legitimacy of corporate action. Whereas the dominant approach to corporate governance theory as well as stewardship theory offer a simple criterion for selecting the stakeholders subject to protection by corporate governance – namely the imperfect contractual relation between a corporation and its shareholders – this criterion is not applicable in the face of the individualization of risk, potentially including every individual. Hence, another selection criterion needs to be found.

One appropriate starting point seems to be the concept of implicit contracts, the criterion used by team production theory to determine how worthy of protection the stakeholders are. Implicit contracts are not formalized but are nevertheless vital elements of economic transactions. Taking into account this type of contract in addition to explicit contracts facilitates the formulation of the relation between firms and an enlarged set of stakeholders in a systematic way, since risk not accounted for in explicit contracts becomes conspicuous (Boatright, 2004, 2011). Nevertheless, despite its potential to address numerous legitimate claims on a corporation, the contractual view has its limits where relations between a corporation and its stakeholders are unidirectional, as in the case of negative externalities of the activities of business firms and the resulting risk for individuals. Redefining corporate responsibility by extending the notion of property rights to 'both the legal aspect of property rights and the social conventions that govern (business) behaviors' (Asher, Mahoney, & Mahoney, 2005) seems to be a promising way to recognize the importance of a firm's stakeholders (Blair, 2005). However, the possibility of defining all stakeholder relations in terms of contracts and property rights, especially under conditions of complex global interdependencies characteristic for risk society, seems to be limited.

Consequently the contract concept is not suitable for grasping the multiple relationships between corporations and their stakeholders. A further starting point is the concept of accountability. 'An accountability relationship is one in which an individual, group or other entity makes demands on an agent to report on his or her activities, and has the ability to impose costs on the agent' (Keohane, 2003: 139). According to Keohane (2003: 140), there are three normative criteria justifying and necessitating the accountability of an actor to specific groups: authorization, support, and impact. (1) *Authorization* defined as the conferring of rights from one entity upon another is seen as one normative reason for the duty of the authorized to be accountable to the authorizer. (2) Political as well as financial *support* is regarded as another rationale for the obligation of the supported to be accountable vis-à-vis the supporters. (3) The third criterion – *impact* – is argued to further justify the agent's obligation to accountability. As argued by Held (2002), actors who become 'choice-determining' for others and restrict the autonomy of these others need to be held accountable.

The issue of accountability in the shareholder-centered approach to corporate governance theory is exclusively centered on the criterion of support. Shareholders provide financial support for a corporation and in turn the corporation is supposed to be accountable to these shareholders. In the light of the growing economic and political power of corporations, the criterion of impact is becoming more and more relevant since corporations determine the choices of many people. However, due to the complexitiy of global exchange- and power-relations, the impact of specific actions on the constraint of individual choice is increasingly difficult to determine in a direct way. Impact in most instances does not happen directly, but through intricate cause–effect chains. Hence, to develop a concept of impact capable of embracing this complexity and intermediateness, we bring in the notion of *social connectedness*. According to Young (2004), to counter injustice – and therewith the constraint of individual choice – resulting from social and economic connectedness in a globalized economy, it is necessary to overcome a past-oriented liability logic. Instead, Young introduces the forward-looking concept of social connectedness. According to her, involvement in structures leading to injustice is regarded as a sufficient condition to consider an actor responsible since individual decisions are constrained due to the impact of this actor's actions. This becomes even more important because corporations not only impact on individuals by economic exchange but also through externalities and the provision of public goods. Under such circumstances impact cannot be determined following the logic of liability. Defining the impact of corporations according to the social connectedness perspective seems to be a fruitful approach with which to determine the scope of corporate accountability. Corporate governance, which plays a central role in securing corporate accountability, has to adapt to the changing economic and political operating conditions of corporations if it is to remain capable of fulfilling this objective. Instead of being centered on the protection of corporate shareholders, it needs to secure corporate accountability to all those affected by corporate action, even indirectly. The notion of social connectedness can be the basis for formulating the specifications of such an extended conceptualization of corporate governance, transcending the narrow focus on contractual relations and incorporating all risks produced by business and not covered by governmental regulation.

4.4 Tackling the Changed Allocation of Risk: The Role of Corporate Governance

We have described the inappropriateness of shareholder-centered approaches to corporate governance in the light of the individualization of risk and the weak link between the maximization of shareholder value and social welfare, and the resulting legitimacy problems of business. Further, we demonstrated the potential suitability of stakeholder democracy to generate corporate legitimacy by including the interests of all parties affected by a firm's activities into corporate decision making. Whereas the stakeholder approach argues that such an inclusion is conducive to the maximization of corporate value, we argue that this argument is not strong enough to encourage corporate decision makers to consider all stakeholders that are exposed to the risks resulting from corporate activities. In the following we firstly show why corporate governance is crucial for guaranteeing a fair allocation of such risks. Secondly, we explain how corporate governance can be modified to achieve this objective. In addition, we analyze the compatibility of a democratization of corporate governance with law and illustrate ways to implement democratic principles on the level of corporate governance by reference to the example of stakeholder panels that are becoming popular among many multinational corporations.

4.4.1 Corporate Governance as a Guarantee for a Fair Allocation of Risks

As shown by Gomez and Korine (2008), an identifiable mechanism is necessary to signal trustworthiness and establish confidence in the governance of corporations so that investors are willing to invest in a corporation and other stakeholders consent to the activities of a corporation. In light of the shifting allocation of risks corporate governance structures that trustworthily signal the capacity of a business firm to limit the risks for stakeholders are crucial for securing organizational legitimacy for several reasons. First, the upper echelons in corporations wield the most power – in economic terms and increasingly also politically. At the top management level fundamental directions in the course of strategic decision making are selected (Hambrick & Mason, 1984; Schreyögg & Steinmann, 1987) that shape the relation between corporations and society (Kemp, 2011) and therefore influence the allocation of risks. Examples are decisions to make a foreign direct investment in a country with a poor human rights record or to engage in a highly disputed industry such as genetic engineering. Second, responsibility for the allocation of risks needs to be easily localized and identified by shareholders as well as by the general public. Whereas the general capacity of a firm to limit the risks for stakeholders is difficult to assess for external observers, the design of corporate governance can serve as a clear signal that business firms take into account their effects on shareholders as well as on other stakeholders. Third, there is a possibility of failure of processes aimed at a fair allocation of risks at the lower levels of a firm. Distortions in moral deliberation resulting from the hierarchical structure of firms and causing a diffusion of personal responsibility (Rhee, 2008) cannot be ruled out. Hence, some kind of guarantee equivalent to a court of last resort is necessary to provide the possibility of changing the direction of corporate activity and to ensure that the risks resulting from the activities of business firms are allocated in a way that is perceived as legitimate by all stakeholders.

4.4.2 Mitigating Risks and Maintaining Legitimacy: The Role of Deliberation in Corporate Governance

In the following we suggest that the opening up of corporate governance structures and corporate control processes to communicative processes with civil society is a suitable way to address the risks resulting from the activities of business firms in a procedural communication-based way and to simultaneously safeguard corporate legitimacy. As a response to the limited capacity of nation states to address the problems associated with the emergence of risk society, Beck (1992, 1997) proposed the concept of *subpolitics* as a way to tackle risk that lie beyond the reach of regulatory authorities. In subpolitics, civil society actors such as communities and NGOs engage in political processes with the aim to compensate for the decreasing regulatory capacity of the nation state. Suggestions to concretize mechanisms for assessing and governing risks within the scope of subpolitics (see, e.g., Bäckstrand, 2004) build on the theory of deliberative democracy (Habermas, 1998; Dryzek, 1999). In this theory deliberation is conceived as a network of argumentation aimed at controlling administrative power by finding rational and fair solutions for problems of public interest (Habermas, 1996). In the course of deliberative processes civil society actors can collectively assess and govern risks in a legitimate manner (see, e.g., Pellizzoni, 2001, for the case of the assessment of the risks of gene technology). With the increasing power of business, firms become increasingly exposed to subpolitical protests (Scherer & Palazzo, 2007). Whereas on the one hand such subpolitical activities are potentially harmful for business firms, on the other hand they open up a new arena for interaction between civil society and business firms, where risks of business activities can be collectively assessed and governed in a communicative way.

Indeed, Palazzo and Scherer (2006) suggested such an engagement of business firms with civil society might be a way to manage the legitimacy of organizations in a procedural communication-based way. Referring to the threefold concept of legitimacy put forward by Suchman (1995) and described above – pragmatic, cognitive, and moral legitimacy – these authors argue that under the conditions of globalization the capability of business to constitute pragmatic or cognitive legitimacy is decreasing. Transfering the theory of deliberative democracy from political science to the context of business organizations (Palazzo & Scherer, 2006; Scherer & Palazzo, 2007), deliberation is regarded as a means for corporations to compensate for the loss of pragmatic and cognitive legitimacy. Switching to a mode of 'moral reasoning' is regarded as a measure to constitute moral legitimacy by means of discursive processes when necessary and appropriate. The process of deliberation is seen as a way to achieve legitimate outcomes by an active justification vis-à-vis society through the exchange of good reasons (Palazzo & Scherer, 2006). These considerations illustrate that the design of corporate governance according to the principles of deliberative democracy has the potential to tackle the risks that result from activities of business firms and to thus safeguard their legitimacy.

4.4.3 Company Law, Soft Law, and Democratic Corporate Governance

Obviously, even if the democratization of corporate governance is an appropriate response to the changing allocation of risks discussed above, the question remains to what extent such a radical redesign of governance structures and profound reallocation of rights is compatible with company law. To elaborate on this question a differentiation between American and European legal approaches to corporate governance seems to be appropriate. In the United States, the maximization of shareholder value is regarded as the exclusive goal of a corporation by most law professors (Elhauge, 2005; Stout, 2008; Williams & Conley, 2005). This perspective prohibits the inclusion of non-shareholding stakeholders in corporate governance, since thus the primacy of the maximization shareholder value is potentially at stake. However, as shown by Stout, the maximization of shareholder value is not a legal principle (Stout, 2008). Rather, corporate law suggests that the purpose of the firm is to 'serve the interests of employees, creditors, customers, and the broader society' (Williams & Conley, 2005: 1190). As we have demonstrated, the democratization of corporate governance is an appropiate means for safeguarding the legitimacy and thus the viability of a business firm in cases where business firms operate under conditions of weak regulatory frameworks. In cases where there is no other means available for guaranteeing the viability of a business firm, an opening up of corporate governance for democratic processes therefore seems to be a lawful means to ensure that a firm can continue to serve the interests of its stakeholders as well as a means to signal this capacity to prospective shareholders (Gomez & Korine, 2008). In addition to the positive influence of stakeholder participation on corporate legitimacy, there is increasing evidence that close interaction with stakeholders on the level of corporate governance is conducive to the management of business risks (Pirson & Turnbull, 2011) as well as to innovation (Spitzeck & Hansen, 2010). These considerations make clear that the representation of stakeholders in corporate governance is not only compatible with legal prescriptions, but might actually be in the economic interest of a firm. This idea of a corporate governance model that is by default attractive for stakeholder groups with allegedly diverging interests partly corresponds with the ideas of Black and Kraakman (1996), who propose a 'self-enforcing model of corporate law' for countries where the official enforcement of contracts is weak. These authors argue that an appropriately designed set of default rules for corporate governance might even work under conditions of weak enforcement due to the pressure of peers, threats to the reputation of a corporation, and the danger of violent protests against decisions of corporations. The same arguments hold as a rationale for a voluntary democratization of corporate governance as a means to tackle the shifting allocation of risks and the concomitant legitimacy problems of business. As argued by Turnbull (2000), the concept of a self-enforcing model of corporate law might serve as the basis for the policies of governments and development agencies to promote democratic forms of corporate governance. Building on this idea, in the following we discuss the feasibility and prospect of a legal and soft-legal enforcement of democratic corporate governance.

As demonstrated by the case of Europe, the inclusion of stakeholders in corporate governance can also be required by law. For instance, German law requires the inclusion of workers' representatives in corporate boards in firms of a certain size. Further, in Norway since 2003 a law requires that 40 percent the directors of business firms are women (Ahern & Dittmar, 2012). Similar laws are implemented or discussed in several other European countries. These examples illustrate that law can play an important role in enforcing the inclusion of different stakeholders in corporate governance.

Beyond strictly legal approaches to the democratization of corporate governance, it is also possible to conceive of soft law approaches to the promotion of democratic corporate governance. For instance, the demand of the OECD Principles of Corporate Governance that the board of a corporation 'should take into account the interests of stakeholders' (OECD, 2004: 24) could conceivably be complemented by a clause that requires the formal inclusion of stakeholders in corporate governance. Further, more indirect effects of soft law on corporate governance are conceivable. For instance, as argued by Muchlinski, the provisions of the UN framework on human rights and business concerning the development of human rights compliance systems have the potential to transform the shareholder-centered model of corporate governance towards a model of the corporation that builds 'upon the implications of stakeholder theory for the reform of corporate law and regulation (Muchlinski, 2012: 167).

At first glance it might appear somewhat paradoxical to conceive required democratization of corporate governance by law or soft law as one means to address problems in areas in which laws are weak. However, at second glance, the described law and soft law approaches might serve as blueprints for indirect legal remedies of governance gaps. Whereas law is incapable to directly address governance gaps per definition, it is conceivable to require business firms to open up their decision structures in their home countries as a means to address problematic issues in host countries. For instance, the inclusion of the representative of a civil society organization that promotes the protection of human rights in the board of a European business firm might be an appropriate means to avoid the complicity of this firm in the violation of human rights in areas where there is no proper rule of law.

Even if these considerations pose several essential questions concerning the selection of stakeholders and the redesign of governance structures, we hold that a democratization of corporate governance required by law or soft law might be a way to indirectly tackle governance gaps. Concerning the concrete form of such a democratization, the emerging practice of stakeholder panels described in the following section has the potential to offer insights.

4.4.4 Concretizing Democratic Corporate Governance: The Case of Stakeholder Panels

Suggestions to modify corporate governance structures reach from the inclusion of outside directors into corporate boards to the comprehensive redesign of corporate governance structures. Ideas to achieve the latter goal comprise suggestions to increase the complexity of corporate governance structures by raising the number of corporate boards (Pirson & Turnbull, 2011; Turnbull, 1994) and to create novel instances such as 'stakeholder liaison groups' (Tricker, 2011) on the one hand and proposals to connect political decisionmaking with societal discurses within a ‘chamber of discourses’ (Dryzek & Niemeyer, 2008) on the other hand.

In practice, it can be observed that more and more business firms interact with stakeholders on a regular basis, often within the scope of stakeholder panels (AccountAbility & Utopies, 2007). In the literature (Scherer et al., 2012; Spitzeck, Hansen, & Grayson, 2011) such stakeholder panels are described as modifications of the corporate governance structures of corporations. In what follows, we show that the emergence of stakeholder panels can be explained with reference to our considerations on the shifting allocation of risks generated by business firms and the role of deliberative democracy on the level of corporate governance for moderating these risks. Basically, the inclusion of stakeholders in corporate governance can either comprise information rights or participation in decision-making (Williamson, 1985). Concerning the case of information rights, there is a range of business firms that engage stakeholder panels in the process of reporting information on social and ecological issues. For instance, the External Report Review Panel of cement producer Holcim has the task to ‘challenge the company’s approach to sustainable development… as well as to form an opinion on the company’s sustainable development performance and reporting’ (Holcim, 2012: 1). The statements of the panel are publicized on the company’s website. Similarly, Kingfisher, a large home improvement retailer, publicizes the feedback of its External Stakeholder Panel as well as the company’s response to this feedback (Kingfisher, 2012). Such processes of review, assurance, and exchange of arguments conform with the principles of deliberative democracy insofar as they can be regarded as a form of public discussion, since the comments of stakeholder panels on sustainability reports of business firms are in many cases published in a (purportedly) uncensored manner, allowing the readers to form their opinion in an unbiased way.

The direct participation of stakeholders in decision making of business firms is currently less developed. Whereas there are a number of stakeholder panels that are designated to inform the formulation of corporate strategies, their actual power to influence corporate decisions seems to be low (see also Spitzeck & Hansen, 2010). However, we regard the emergence of forums for the exchange of information between top-level managers and stakeholders as a noticeable improvement of governance structures. Such forums firstly increase the informational basis for organizational decision-making. Secondly, they constitute an arena for the mutual exchange of information that is potentially conducive to mutual understanding and a change of practices in accordance with this. Interestingly, stakeholder panels resemble the ‘stakeholder advisory boards’ conceived by Evan and Freeman (1988) as a transitional step toward a stakeholder controlled corporation.

The reasons for setting up stakeholder panels are manifold. On the one hand, the input of stakeholder panels can be primarily regarded as an instrumental means aimed at detecting factors that affect the success of a company, as exemplified by the Sustainability External Advisory Council of Dow Chemical that addresses corporate success factors, business/portfolio success factors, public affairs and stakeholder engagement, and trends and externalities (Dow Chemical, 2012). However, on the other hand, in some cases the purpose of stakeholder panels transcends immediate economic considerations. There is evidence that the shifting allocation of risks described above seems to be increasingly recognized on the part of business. For instance, one of the stated purposes of the Sustainable Development Panel of energy producer EDF is to assess how well the interests of stakeholders are taken into account (EDF, 2012). Similarly, monitoring the efforts of business firms to protect human rights is the focus of many stakeholder panels (see, e.g., Areva, 2007; BP, 2013). This can be taken as evidence that business firms increasingly realize that stakeholders might be in need of additional protection beyond legal protection. Next, a topic that permeates many reports and mission statements of stakeholder panels (see, e.g., Dow Chemical, 2012; Holcim, 2012; Shell, 2012) is the issue of climate change, which is the most striking example for negative externalities generated by business firms. Finally, the provision of public goods such as healthcare, education and public transport by business firms is increasingly moving into the scope of stakeholder panels, as the example of BP’s Tangguh Independent Advisory Panel in Indonesia illustrates (BP, 2013).

The described involvement of stakeholders in corporate governance illustrates that business firms increasingly recognize the risks resulting from their activities for their stakeholders. The inclusion of stakeholders in organizational decision processes on a regular basis can be regarded as the attempt of business firms to address the shortcomings of a shareholder-centered approach to corporate governance by transcending the casual consultation of stakeholders, which are often characterized by unequal power relations (Banerjee, 2008). Through the inclusion of stakeholders corporate governance becomes a subpolitical arena, which can (at least provisionally and partly) compensate for lacking governmental and regulatory protection of stakeholders from risks and contribute to the legitimacy of business firms.

4.5 Concluding Remarks and Directions for Further Research

In the pre-globalization era non-shareholding stakeholders of business firms were in many cases sufficiently protected by law and regulation, negative externalities were (at least partly) avoided or compensated by law and proper state governance, and the provision of public goods was a public task fulfilled by public authorities. With the diminution of public steering power and the widening of regulation gaps, these assumptions are becoming partly untenable. In many cases, stakeholders of business firms lack protection by nation-state legislation. The limitation of negative externalities by state authorities is becoming increasingly difficult due to the global reach of corporate power, the range of many negative externalities transcending national borders, and the weakening of national regulatory frameworks. The distinction between the private and the public sphere is blurring because corporations often participate or independently engage in the provision of public goods. As a result, many stakeholders of business firms are increasingly individually exposed to risk that results from corporate activities and the assumed link between the maximization of shareholder value and social welfare is weakening – with adverse effects on the legitimacy and viability of business firms.

Corporate governance has the potential to address these issues. To successfully moderate between the interests of individuals, of corporations, and of society and thereby to maintain or restore organizational legitimacy, corporate governance needs to be open to contingent legitimate claims on a corporation with the aim of controlling and mitigating risks resulting from corporate action. The suggested approach builds on stakeholder theory. However, we extend it insofar as we not only claim the need to consider corporate stakeholders in corporate decisions, but also demand the inclusion of all corporate stakeholders that are negatively affected by corporate activities into organizational decision processes. The transfer of the concept of deliberative democracy to the corporate level in general and to corporate governance in particular promises to tackle the risks which result from the activities of business in a globalized economy and to realign the objectives of business firms and society in a discursive way. Thus the moral deficiencies of shareholder-centered corporate governance can be addressed and the legitimacy of a business firm can be reestablished.

Our findings contribute to extant research on the democratization of corporate governance (see, e.g., Driver & Thompson, 2002; Gomez & Korine, 2005, 2008; Parker, 2002; Scherer et al., 2012; Spitzeck et al., 2011) in several regards. First, we show that shareholder-centered approaches to corporate governance that are justified by the residual risk borne by shareholders or by the maximization of social welfare allegedly accruing from the maximization of shareholder value are not appropriate in light of globalization and the individualization of risk in risk society. For this reason, these approaches are a potential threat to the legitimacy of business firms. We detail that democratic processes on the level of corporate governance can help avoid undue risks for stakeholders, ensure the contribution of business to the social good, and therefore help maintain or restore the legitimacy of business. Next, we show that reliance on contracts as a criterion for determining the inclusion of stakeholders in corporate governance is increasingly inappropriate in view of the complexity of global exchange relations and the unilateral exercise of power through business firms. Instead, we suggest that the concept of social connectedness can serve as criterion for the selection of stakeholders to be represented in corporate governance. Finally, we show that a legally or soft-legally mandated democratization of corporate governance of business firms in home countries of a firm where law is assumed to be relatively strong might be an approach appropriate for indirectly tackling governance gaps in areas where law and regulation are weak.

Further research is firstly necessary to find ways to process and balance legitimate claims towards an organization and organizational efficiency. One promising step in this direction is the further analysis of the compatibility of cybernetics-based approaches to organizational design (e.g. Pirson & Turnbull, 2011; Romme & Endenburg, 2006) and the principles of deliberative democracy (e.g. Dryzek, 1999; Habermas, 1996, 1998). Secondly, on the level of global governance, effective schemes of regulation need to be found to foster corporate commitment for goals that transcend the generation of shareholder value and to facilitate the adoption of more versatile forms of corporate governance.

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